

Fortress Investment Group LLC  
Form 10-Q  
August 09, 2010  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 30, 2010

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**  
(State or other jurisdiction of incorporation

or organization)

**20-5837959**  
(I.R.S. Employer

Identification No.)

**1345 Avenue of the Americas, New York, NY**  
(Address of principal executive offices)

**(212) 798-6100**

**10105**  
(Zip Code)

(Registrant's telephone number, including area code)

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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: 165,036,886 outstanding as of August 3, 2010.

Class B Shares: 300,273,852 outstanding as of August 3, 2010.

**Table of Contents**

**FORTRESS INVESTMENT GROUP LLC**

**FORM 10-Q**

**INDEX**

	<b>PAGE</b>
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Financial Statements	
<u>Consolidated Balance Sheets as of June 30, 2010 (unaudited) and December 31, 2009</u>	1
<u>Consolidated Statements of Operations (unaudited) for the three and six months ended June 30, 2010 and 2009</u>	2
<u>Consolidated Statement of Equity (unaudited) for the six months ended June 30, 2010</u>	3
<u>Consolidated Statements of Cash Flows (unaudited) for the six months ended June 30, 2010 and 2009</u>	4
<u>Notes to Consolidated Financial Statements (unaudited)</u>	5
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	38
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	68
Item 4. <u>Controls and Procedures</u>	71
<b>PART II. OTHER INFORMATION</b>	
Item 1. <u>Legal Proceedings</u>	72
Item 1A. <u>Risk Factors</u>	72
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	103
Item 3. <u>Defaults upon Senior Securities</u>	103
Item 4. <u>Reserved</u>	103
Item 5. <u>Other Information</u>	103
Item 6. <u>Exhibits</u>	104
<u>SIGNATURES</u>	105

## Table of Contents

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

Management Fee Paying Assets Under Management, or AUM, refers to the management fee paying assets we manage, including, as applicable, 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 capital commitments or invested capital (or NAV, if lower) of our private equity funds and credit PE funds, depending on which measure management fees are being calculated upon at a given point in time, which in connection with private equity funds raised after March 2006 includes the mark-to-market value of public securities held within the funds,
- (ii) the contributed capital of our publicly traded alternative investment vehicles, which we refer to as our Castles,
- (iii) the net asset value, or NAV, of our hedge funds, including the Value Recovery Funds which pay fees based on realizations (and on certain managed assets); and
- (iv) the NAV of our managed accounts, to the extent management fees are charged.

For each of the above, the amounts exclude 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 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 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, collectively, to Fortress Investment Group LLC and its subsidiaries, including the Fortress Operating Group and all of its subsidiaries.

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 January 2007, and in each of which Fortress Investment Group LLC acquired an indirect controlling interest in January 2007.

principals or 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 related transactions directly owned 100% of the Fortress Operating Group units and following completion of our initial public offering and related transactions own a majority of the Fortress Operating Group units and 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 and grants by Fortress and dispositions by the principals.

## **Table of Contents**

### **SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Some of the statements under Part II, Item 1A, Risk Factors, 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 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, estimates, anticipates 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. Accordingly, you should not place undue reliance on any forward-looking 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.

### **SPECIAL NOTE REGARDING EXHIBITS**

In reviewing the agreements included as exhibits to this Quarterly Report on Form 10-Q, please remember they are included to provide you with information regarding their terms and are not intended to provide any other factual or disclosure information about the Company or the other parties to the agreements. The agreements contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties have been made solely for the benefit of the other parties to the applicable agreement and:

should not in all instances be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements prove to be inaccurate;

have been qualified by disclosures that were made to the other party in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;

may apply standards of materiality in a way that is different from what may be viewed as material to you or other investors; and

were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement and are subject to more recent developments.

Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time. Additional information about the Company may be found elsewhere in this Quarterly Report on Form 10-Q and the Company's other public filings, which are available without charge through the SEC's website at <http://www.sec.gov>.

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS  
FORTRESS INVESTMENT GROUP LLC****CONSOLIDATED BALANCE SHEETS**

(dollars in thousands, except share data)

	<b>June 30, 2010 (Unaudited)</b>	<b>December 31, 2009</b>
<b>Assets</b>		
Cash and cash equivalents	\$ 167,527	\$ 197,099
Due from affiliates	132,243	64,511
Investments	869,432	867,215
Deferred tax asset	454,806	440,639
Other assets	114,831	90,803
	<b>\$ 1,738,839</b>	<b>\$ 1,660,267</b>
<b>Liabilities and Equity</b>		
<b>Liabilities</b>		
Accrued compensation and benefits	\$ 101,413	\$ 131,134
Due to affiliates	351,979	345,976
Deferred incentive income	244,966	160,097
Debt obligations payable	355,900	397,825
Other liabilities	35,543	25,921
	<b>1,089,801</b>	<b>1,060,953</b>
<b>Commitments and Contingencies</b>		
<b>Equity</b>		
Class A shares, no par value, 1,000,000,000 shares authorized, 165,036,886 and 145,701,622 shares issued and outstanding at June 30, 2010 and December 31, 2009, respectively		
Class B shares, no par value, 750,000,000 shares authorized, 300,273,852 and 307,773,852 shares issued and outstanding at June 30, 2010 and December 31, 2009, respectively		
Paid-in capital	1,252,148	1,029,536
Retained earnings (accumulated deficit)	(944,529)	(767,994)
Accumulated other comprehensive income (loss)	(1,075)	(325)
Total Fortress shareholders' equity	306,544	261,217
Principals and others' interests in equity of consolidated subsidiaries	342,494	338,097
Total equity	649,038	599,314
	<b>\$ 1,738,839</b>	<b>\$ 1,660,267</b>

See notes to consolidated financial statements



**Table of Contents****FORTRESS INVESTMENT GROUP LLC****CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

(dollars in thousands, except share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
<b>Revenues</b>				
Management fees from affiliates	\$ 112,894	\$ 108,425	\$ 219,430	\$ 214,077
Incentive income from affiliates	28,849	6,958	46,405	6,958
Expense reimbursements from affiliates	40,794	20,661	63,861	33,708
Other revenues (affiliate portion disclosed in Note 6)	8,793	3,043	21,822	6,640
	191,330	139,087	351,518	261,383
<b>Expenses</b>				
Interest expense	3,698	7,605	7,494	15,791
Compensation and benefits	159,529	113,456	338,922	222,692
Principals agreement compensation	237,367	237,367	472,126	472,126
General, administrative and other	24,242	21,034	45,350	38,219
Depreciation and amortization	3,294	2,761	5,976	5,402
	428,130	382,223	869,868	754,230
<b>Other Income (Loss)</b>				
Gains (losses) from investments	(12,957)	19,441	(12,385)	16,968
Tax receivable agreement liability adjustment			1,317	(55)
Earnings (losses) from equity method investees	6,150	51,057	26,031	16,208
	(6,807)	70,498	14,963	33,121
<b>Income (Loss) Before Income Taxes</b>	(243,607)	(172,638)	(503,387)	(459,726)
Income tax benefit (expense)	(7,634)	1,308	(9,186)	1,715
<b>Net Income (Loss)</b>	\$ (251,241)	\$ (171,330)	\$ (512,573)	\$ (458,011)
<b>Principals and Others Interests in Income (Loss) of Consolidated Subsidiaries</b>				
	\$ (158,857)	\$ (126,738)	\$ (336,038)	\$ (346,260)
<b>Net Income (Loss) Attributable to Class A Shareholders</b>	\$ (92,384)	\$ (44,592)	\$ (176,535)	\$ (111,751)
<b>Dividends declared per Class A share</b>	\$	\$	\$	\$
<b>Earnings Per Class A share - Fortress Investment Group</b>				
Net income (loss) per Class A share, basic	\$ (0.57)	\$ (0.40)	\$ (1.14)	\$ (1.10)
Net income (loss) per Class A share, diluted	\$ (0.57)	\$ (0.41)	\$ (1.16)	\$ (1.10)
Weighted average number of Class A shares outstanding, basic	165,246,781	115,547,744	161,385,135	105,447,324



## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Weighted average number of Class A shares outstanding, diluted	165,246,781	427,619,294	465,388,269	417,518,874
--	-------------	-------------	-------------	-------------

See notes to consolidated financial statements

2

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****CONSOLIDATED STATEMENT OF EQUITY (Unaudited)**

FOR THE SIX MONTHS ENDED JUNE 30, 2010

(dollars in thousands)

	Class A Shares	Class B Shares	Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Fortress Shareholders Equity	Principals and Others Interests in Equity of Consolidated Subsidiaries	Total Equity
<b>Equity - December 31, 2009</b>	145,701,622	307,773,852	\$ 1,029,536	\$ (767,994)	\$ (325)	\$ 261,217	\$ 338,097	\$ 599,314
Contributions from principals and others interests in equity							63,815	63,815
Distributions to principals and others interests in equity			(661)			(661)	(95,525)	(96,186)
Conversion of Class B to Class A shares	7,500,000	(7,500,000)	7,188			7,188	(7,188)	
Net deferred tax effects resulting from acquisition of Fortress Operating Group units			4,559			4,559		4,559
Net deferred tax effects resulting from exchange of Fortress Operating Group units			7,262			7,262		7,262
Director restricted share grant	210,302		135			135	262	397
Capital increase related to equity-based compensation, net	11,624,962		196,596			196,596	388,996	585,592
Dilution impact of Class A share issuance			7,533			7,533	(7,533)	
Comprehensive income (loss) (net of tax)				(176,535)		(176,535)	(336,038)	(512,573)
Foreign currency translation					(177)	(177)	(663)	(840)
Comprehensive income (loss) from equity method investees					(573)	(573)	(1,729)	(2,302)
Total comprehensive income (loss)								(515,715)

Edgar Filing: Fortress Investment Group LLC - Form 10-Q

<b>Equity - June 30, 2010</b>	165,036,886	300,273,852	\$ 1,252,148	\$ (944,529)	\$ (1,075)	\$ 306,544	\$ 342,494	\$ 649,038
-----------------------------------	-------------	-------------	--------------	--------------	------------	------------	------------	------------

See notes to consolidated financial statements

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

JUNE 30, 2010

(dollars in thousands)

	<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash Flows From Operating Activities</b>		
Net income (loss)	\$ (512,573)	\$ (458,011)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities		
Depreciation and amortization	5,976	5,402
Other amortization and accretion	1,678	6,887
(Earnings) losses from equity method investees	(26,031)	(16,208)
Distributions of earnings from equity method investees	4,076	771
(Gains) losses from investments	12,385	(16,968)
Deferred incentive income	(46,677)	
Deferred tax (benefit) expense	2,440	(7,160)
Tax receivable agreement liability adjustment	(1,317)	55
Equity-based compensation	584,155	577,949
Allowance for doubtful accounts	(2,447)	
Other	1,005	
Cash flows due to changes in		
Due from affiliates	(67,975)	(32,219)
Other assets	838	1,551
Accrued compensation and benefits	21,640	(92,918)
Due to affiliates	(9,346)	(16,126)
Deferred incentive income	131,546	
Other liabilities	(1,397)	(3,166)
Net cash provided by (used in) operating activities	97,976	(50,161)
<b>Cash Flows From Investing Activities</b>		
Contributions to equity method investees	(31,694)	(39,261)
Distributions of capital from equity method investees	46,124	27,548
Purchase of fixed assets	(1,522)	(1,664)
Acquisitions, net of cash received	(13,474)	
Net cash provided by (used in) investing activities	(566)	(13,377)
<b>Cash Flows From Financing Activities</b>		
Repayments of debt obligations	(41,925)	(289,291)
Payment of deferred financing costs		(4,162)
Proceeds from public offering		230,000
Costs related to public offering		(10,500)
Principals and others interests in equity of consolidated subsidiaries - contributions	56	67
Principals and others interests in equity of consolidated subsidiaries - distributions	(85,113)	(35,407)
Net cash provided by (used in) financing activities	(126,982)	(109,293)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>(29,572)</b>	<b>(172,831)</b>
<b>Cash and Cash Equivalents, Beginning of Period</b>	<b>197,099</b>	<b>263,337</b>

Edgar Filing: Fortress Investment Group LLC - Form 10-Q

<b>Cash and Cash Equivalents, End of Period</b>	\$ 167,527	\$ 90,506
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash paid during the period for interest	\$ 6,583	\$ 8,095
Cash paid during the period for income taxes	\$ 6,006	\$ 5,952
<b>Supplemental Schedule of Non-cash Investing and Financing Activities</b>		
Employee compensation invested directly in subsidiaries	\$ 64,021	\$ 1,847
Investments of receivable amounts into Fortress Funds	\$ 8,092	\$
Dividends, dividend equivalents and Fortress Operating Group unit distributions declared but not yet paid	\$ 4,337	\$
Distributions declared but not yet paid on other non-controlling interests	\$ 23,614	\$
Contingent consideration in purchase of Logan Circle Partners L.P.	\$ 4,000	\$

See notes to consolidated financial statements

**Table of Contents**

**FORTRESS INVESTMENT GROUP LLC**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(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 primary 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 the following business segments in which Fortress operates:

- 1) Private equity:
  - a) Private equity funds, which make significant, control-oriented investments in debt and equity securities of public or privately held entities in North America and Western Europe, with a focus on acquiring and building assets-based businesses with significant cash flows; and
  - b) Publicly traded alternative investment vehicles, which Fortress refers to as Castles, which are companies that invest primarily in real estate and real estate related debt investments.
- 2) Liquid hedge funds, which invest globally in fixed income, currency, equity and commodity markets, and related derivatives to capitalize on imbalances in the financial markets.
- 3) Credit funds:
  - a) Credit hedge funds, which make highly diversified investments globally in assets, opportunistic lending situations and securities throughout the capital structure with a value orientation, as well as in investment funds managed by external managers, and which include non-Fortress originated funds for which Fortress has been retained as manager as part of an advisory business; and
  - b) Credit private equity ( PE ) funds which are comprised of a family of credit opportunities funds focused on investing in distressed and undervalued assets, a family of long dated value funds focused on investing in undervalued assets with limited current cash flows and long investment horizons, a family of real assets funds focused on investing in tangible and intangible assets in four principal categories (real estate, capital assets, natural resources and intellectual property), and an Asian fund.
- 4) Principal investments in the above described funds.

***Financial Statement Guide***

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Selected Financial Statement Captions <u>Balance Sheet</u>	Note Reference	Explanation
Due from Affiliates	6	Generally, management fees, expense reimbursements and incentive income due from Fortress Funds.
Investments	3	Primarily the carrying value of Fortress's principal investments in the Fortress Funds.
Deferred Tax Asset	5	Relates to potential future tax benefits.
Due to Affiliates	6	Generally, amounts due to the Principals related to their interests in Fortress Operating Group and the tax receivable agreement.
Deferred Incentive Income	2	Incentive income already received from certain Fortress Funds based on past performance, which is subject to contingent repayment based on future performance.
	5	

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

<b>Selected Financial Statement Captions</b>	<b>Note Reference</b>	<b>Explanation</b>
Debt Obligations Payable	4	The balance outstanding on the credit agreement.
Principals and Others Interests in Equity of Consolidated Subsidiaries	6	The GAAP basis of the Principals' ownership interests in Fortress Operating Group as well as employees' ownership interests in certain subsidiaries.
<b><u>Statement of Operations</u></b>		
Management Fees from Affiliates	2	Fees earned for managing Fortress Funds, generally determined based on the size of such funds.
Incentive Income from Affiliates	2	Income earned from Fortress Funds, based on the performance of such funds.
Compensation and Benefits	7	Includes equity-based, profit-sharing and other compensation to employees.
Principals Agreement Compensation	N/A	As a result of the principals agreement, the value of a significant portion of the Principals' equity in Fortress prior to the Nomura Transaction is being recorded as an expense over a five year period. Fortress is not a party to this agreement. It is an agreement between the Principals to further incentivize them to remain with Fortress. This GAAP expense has no economic effect on Fortress or its shareholders.
Gains (Losses) from Investments	N/A	The result of asset dispositions or changes in the fair value of assets which are marked to market (primarily the Castles and GAGFAH).
Tax Receivable Agreement Liability Adjustment	5	Represents a change in the amount due to the Principals under the tax receivable agreement.
Earnings (Losses) from Equity Method Investees	3	Fortress's share of the net earnings (losses) of the Fortress Funds resulting from its principal investments.
Income Tax Benefit (Expense)	5	The net tax result related to the current period. Certain of Fortress's revenues are not subject to taxes because they do not flow through taxable entities. Furthermore, Fortress has significant permanent differences between its GAAP and tax basis earnings.
Principals and Others Interests in (Income) Loss of Consolidated Subsidiaries	6	Primarily the Principals' and employees' share of Fortress's earnings based on their ownership interests in subsidiaries, including Fortress Operating Group.
Earnings Per Share	8	GAAP earnings per Class A share based on Fortress's capital structure, which is comprised of outstanding and unvested equity interests, including interests which participate in Fortress's earnings, at both the Fortress and subsidiary levels.





**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

<b>Selected Financial Statement Captions</b>	<b>Note Reference</b>	<b>Explanation</b>
<u>Other</u>		
Distributions	8	A summary of dividends and distributions, and the related outstanding shares and units, is provided.
Distributable Earnings	10	A presentation of our financial performance by segment (fund type) is provided, on the basis of the operating performance measure used by Fortress's management committee.

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 should be read in conjunction with Fortress's consolidated and combined financial statements for the year ended December 31, 2009 and notes thereto included in Fortress's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 1, 2010. Capitalized terms used herein, and not otherwise defined, are defined in Fortress's consolidated financial statements for the year ended December 31, 2009.

**2. MANAGEMENT AGREEMENTS AND FORTRESS FUNDS**

Fortress has two principal sources of income from its agreements with the Fortress Funds: contractual management fees, which are generally based on a percentage of fee paying assets under management, and related incentive income, which is generally based on a percentage of profits subject to the achievement of performance criteria. Substantially all of Fortress's net assets, after deducting the portion attributable to principals and others' interests, are a result of principal investments in, or receivables from, these funds.

The Fortress Funds are divided into segments and Fortress's agreements with each are detailed below.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

**Management Fees, Incentive Income and Related Profit Sharing Expense**

Fortress recognized management fees and incentive income as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Private Equity				
Private Equity Funds				
Management fees - affil.	\$ 33,507	\$ 38,921	\$ 66,972	\$ 76,590
Incentive income - affil.	27,426		27,426	
Castles				
Management fees - affil.	11,074	11,950	22,854	23,340
Incentive income - affil.				
Management fees - non-affil. (A)	490	694	1,374	1,340
Liquid Hedge Funds				
Management fees - affil.	17,815	19,893	35,281	42,497
Incentive income - affil.	116	144	(143)	144
Management fees - non-affil. (A)	1,668		3,004	25
Incentive income - non-affil. (A)				
Credit Funds				
Credit Hedge Funds				
Management fees - affil.	39,341	29,307	73,009	57,215
Incentive income - affil.			(129)	
Management fees - non-affil. (A)	431	195	812	409
Incentive income - non-affil. (A)	380	163	8,308	985
Credit PE Funds				
Management fees - affil.	11,157	8,354	21,314	14,435
Incentive income - affil.	1,307	6,814	19,251	6,814
Management fees - non-affil. (A)				
Other				
Management fees - non-affil. (A) (C)	3,695		3,695	
Total				
Management fees - affil.	\$ 112,894	\$ 108,425	\$ 219,430	\$ 214,077
Incentive income - affil. (B)	\$ 28,849	\$ 6,958	\$ 46,405	\$ 6,958
Management fees - non-affil. (A)	\$ 6,284	\$ 889	\$ 8,885	\$ 1,774
Incentive income - non-affil. (A)	\$ 380	\$ 163	\$ 8,308	\$ 985

(A) Included in Other Revenues on the statement of operations.

(B) See Deferred Incentive Income below.

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

(C) Related to Logan Circle.  
Deferred Incentive Income

Incentive income from certain Fortress Funds, primarily private equity funds and credit PE funds, is received when such funds realize profits, based on the related agreements. However, this incentive income is subject to contingent repayment by Fortress to the funds until certain overall fund performance criteria are met. Accordingly, Fortress does not recognize this incentive income as revenue until the related contingencies are resolved. Until such time, this incentive income is recorded on the balance sheet as deferred incentive income and is included as

distributed-unrecognized deferred incentive income in the table below. Incentive income from such funds, based on their net asset value, which has not yet been received is not recorded on the balance sheet and is included as undistributed deferred incentive income in the table below.

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), is generally received subsequent to year end, and has not been recognized for these funds during the six months ended June 30, 2010 and 2009. If the amount

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

of incentive income contingent on achieving annual performance criteria was not contingent on the results of the subsequent quarters, \$9.7 million and \$0.1 million of additional incentive income from affiliates would have been recognized during the six months ended June 30, 2010 and 2009, respectively. Incentive income based on achieving annual performance criteria that has not yet been recognized, if any, is not recorded on the balance sheet and is included as undistributed deferred incentive income in the table below.

During the six months ended June 30, 2010 and 2009, Fortress recognized \$19.3 million and \$6.8 million, respectively, of incentive income distributions from its credit PE funds which represented tax distributions. These tax distributions are not subject to clawback and reflect a cash amount equal to the amount expected to be paid out by Fortress for taxes or tax-related distributions on the allocated income from such funds.

Deferred incentive income from the Fortress Funds, subject to contingent repayment, was comprised of the following, on an inception to date basis:

	Distributed- Gross	Distributed- Recognized (A)	Distributed- Unrecognized (B)	Undistributed net of intrinsic clawback (C) (D)
Deferred incentive income as of December 31, 2009	\$ 503,415	\$ (343,318)	\$ 160,097	\$ 168,686
Share of income (loss) of Fortress Funds				83,311
Distribution of incentive income	131,546		131,546	(131,546)
Recognition of previously deferred incentive income		(46,677)	(46,677)	
Deferred incentive income as of June 30, 2010	\$ 634,961	\$ (389,995)	\$ 244,966	\$ 120,451

(A) All related contingencies have been resolved.

(B) Reflected on the balance sheet.

(C) At June 30, 2010, the net undistributed incentive income is comprised of \$203.8 million of gross undistributed incentive income, net of \$83.3 million of intrinsic clawback (see next page). The net undistributed incentive income amount represents the amount that would be received by Fortress from the related funds if such funds were liquidated on June 30, 2010 at their net asset values.

(D) From inception to June 30, 2010, Fortress has paid \$172.4 million of compensation expense under its employee profit sharing arrangements (Note 7) in connection with distributed incentive income, of which \$27.9 million has not been expensed because management has determined that it is not probable of being incurred as an expense and will be recovered from the related employees. If the \$203.8 million of gross undistributed incentive income were realized, Fortress would recognize and pay an additional \$95.8 million of compensation expense.



**Table of Contents**

**FORTRESS INVESTMENT GROUP LLC**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

The following tables summarize information with respect to the Fortress Funds, other than the Castles, and their related incentive income thresholds as of June 30, 2010:

Fund (Vintage)	Maturity Date (B)	Inception to Date Capital Invested (C)	Inception to Date Distributions (D)	Net Asset Value ( NAV ) (E)	NAV Surplus (Deficit) (C)	Current Preferred Return Threshold (D)	Gain to Cross Incentive Income Threshold (E)	Undistributed Incentive Income (F)	Distributed Incentive Income (G)	Distributed Incentive Subject to Clawback (H)	Gross Intrinsic Clawback (I)	Net Intrinsic Clawback (J)
<b>Private Equity Funds</b>												
NIH (1998)	Indefinite	\$ 415,574	\$ (782,065)	\$ 34,142	N/A	\$	N/A	\$	\$ 94,513	\$	\$	\$
Fund I (1999) (J)	Apr-10	1,062,177	(2,711,651)	173,626	1,823,100		N/A	15,377	292,099			
Fund II (2002)	Feb-13	1,974,296	(3,045,345)	273,275	1,344,324		N/A	13,728	250,811	49,320		
Fund III (2004)	Jan-15	2,762,993	(1,307,372)	1,393,804	(61,817)	843,006	\$ 904,823		66,903	66,903	\$ 66,903	\$ 45,108
Fund III Coinvestment (2004)	Jan-15	273,648	(90,925)	168,203	(14,520)	111,246	125,766					
Fund IV (2006)	Jan-17	3,639,561	(119,640)	2,662,599	(857,322)	980,394	1,837,716					
Fund IV Coinvestment (2006)	Jan-17	762,696	(12,676)	542,622	(207,398)	212,451	419,849					
<b>GAGACQ</b>												
Fund (2004)	Nov-09	545,663	(595,401)	N/A	N/A	N/A	N/A	N/A	51,476	N/A	N/A	N/A
FRID (2005)	Apr-15	1,220,228	(505,605)	358,010	(356,613)	405,843	762,456		16,447	16,447	16,447	10,041
FRIC (2006)	May-16	328,754	(17,460)	136,088	(175,206)	113,931	289,137					
FICO (2006)	Jan-17	724,525		6,322	(718,203)	229,867	948,070					
FHIF (2006)	Jan-17	1,436,386	(63,154)	1,251,047	(122,185)	409,230	531,415					
<b>Mortgage Opportunities</b>												
Fund III (2008)	Jun-13	193,861	(34,753)	110,643	(48,465)		48,465					
									\$ 29,105	\$ 772,249	\$ 132,670	\$ 83,350 \$ 55,149
<b>PE Funds in Investment Period</b>												
Fund V (2007)	Feb-18	\$ 3,613,917	\$ (2,570)	\$ 1,930,229	\$ (1,681,118)	\$ 621,313	\$ 2,302,431	\$	\$	\$	\$	\$
Fund V Coinvestment (2007)	Feb-18	936,145	(126)	452,080	(483,939)	180,933	664,872					
FECI (2007)	Feb-18	982,779	(144)	749,371	(233,264)	243,392	476,656					
									\$	\$	\$	\$

Edgar Filing: Fortress Investment Group LLC - Form 10-Q

<u>Credit PE Funds</u>										
Long Dated Value Fund I (2005)										
	Apr-30	\$ 267,325	\$ (45,629)	\$ 244,637	\$ 22,941	\$ 63,196	\$ 40,255	\$	\$	\$
Long Dated Value Fund II (2005)										
	Nov-30	270,783	(50,548)	241,339	21,104	50,314	29,210		412	
Long Dated Value Fund III (2007)										
	Feb-32	334,665	(76,217)	314,215	55,767		N/A	8,447	1,983	
LDVF Patent Fund (2007)										
	Nov-27	35,268	(8,645)	45,783	19,160		N/A	1,322	484	
								\$ 9,769	\$ 2,879	\$ \$

<u>Credit PE Funds in Investment Period</u>										
Real Assets Fund (2007)										
	Jun-17	\$ 270,349	\$ (89,992)	\$ 220,005	\$ 39,648		N/A	\$ 4,886	\$ 1,316	\$ \$
Assets Overflow Fund (2008)										
	May-18	90,500	(57,070)	50,128	16,698		N/A	1,004	662	29
Credit Opportunities Fund (2008)										
	Oct-20	3,411,136	(3,356,582)	1,232,407	1,177,853		N/A	119,314	114,220	81,176
FTS SIP L.P. (2008)										
	Oct-18	662,642	(707,681)	208,464	253,503		N/A	14,899	35,697	31,091
Credit Opportunities Fund II (2009)										
	Jul-22	328,646	(12,691)	326,019	10,064		N/A	2,404		
Net Lease Fund I (2010)										
	Jan-23	4,914		4,597	(317)	78	395			
FCO MA LSS (2010)										
	Jun-24	25,375		24,950	(425)	143	568			
FCO MA II (2010)										
	Jun-22	20,500		20,240	(260)	4	264			
Japan Opportunity Fund (2009)										
	Jun-19	374,161	(146,323)	258,758	30,920		N/A	8,525		
								\$ 151,032	\$ 151,895	\$ 112,296 \$ \$



**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

	Incentive Income Eligible NAV (K)	Gain to Cross Incentive Income Threshold (L)	Percentage of Incentive Income Eligible NAV Above Incentive Income Threshold (M)	Undistributed Incentive Income (N)	Year to date Incentive Income Crystallized (O)
<b>Liquid Hedge Funds</b>					
<b>Macro Funds (P)</b>					
Main fund investments	\$ 2,178,065	\$ 17,908	35.9%	\$ 3,108	\$ 523
Sidepocket investments (Q)	81,822	49,670	N/A	768	
Sidepocket investments - redeemers (R)	230,712	134,054	N/A	511	
<b>Fortress Commodities Funds (S)</b>					
Main fund investments	975,835	13,519	11.9%	569	1
<b>Credit Hedge Funds</b>					
<b>Special Opportunities Funds (S)</b>					
Main fund investments	\$ 2,595,930	\$	100.0%	\$ 4,632	\$
Sidepocket investments (Q)	183,844	66,459	N/A	1,864	
Sidepocket investments - redeemers (R)	219,963	61,119	N/A	155	
Main fund investments (liquidating) (T)	1,937,470	255,660	40.0%	819	
<b>Fortress Partners Funds (S)</b>					
Main fund investments	224,898	69,557	33.5%	755	
Sidepocket investments (Q)	101,879	23,013	N/A	352	
<b>Worden Fund</b>					
Main fund investments	87,205	1,228	0.0%		

(A) Vintage represents the year in which the fund was formed.

(B) Represents the contractual maturity date including the assumed exercise of all extension options, which in some cases may require the approval of the applicable fund advisory board. Private equity funds that have reached their maturity date are included in the table to the extent they have generated incentive income.

(C) Represents the gain needed to cross the incentive income threshold (as described in (E) below), excluding the impact of any relevant performance (i.e. preferred return) thresholds (as described in (D) below). The aggregate NAV deficit, net of surpluses, of the private equity funds was \$1.8 billion as of period end.

(D) Represents the gain needed to achieve the current relevant performance thresholds, assuming the gain described in (C) above is already achieved.

(E)

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Represents the immediate increase in NAV needed for Fortress to begin earning incentive income, including the achievement of any relevant performance thresholds. It does not include the amount needed to earn back intrinsic clawback (see (I) below), if any. Incentive income is not recorded as revenue until it is received and any related contingencies are resolved (see (H) below).

- (F) Represents the amount of additional incentive income Fortress would receive if the fund were liquidated at the end of the period at its NAV.
- (G) Represents the amount of incentive income previously received from the fund since inception.
- (H) Represents the amount of incentive income previously received from the fund which is still subject to contingencies and is therefore recorded on the consolidated balance sheet as Deferred Incentive Income. This amount will either be recorded as revenue when all related contingencies are resolved, or, if the fund does not meet certain performance thresholds, will be returned by Fortress to the fund (i.e., clawed back ).
- (I) Represents the amount of incentive income previously received from the fund that would be clawed back (i.e., returned by Fortress to the fund) if the fund were liquidated at the end of the period at its NAV, excluding the effect of any tax adjustments. Employees, former employees and affiliates of Fortress would be required to return a portion of this incentive income that was paid to them under profit sharing arrangements. Gross and Net refer to amounts that are gross and net, respectively, of this employee/affiliate portion of the intrinsic clawback. Fortress remains liable to the funds for these amounts even if it is unable to collect the amounts from employees/affiliates. Fortress withheld a portion of the amounts due to employees under these profit sharing arrangements as a reserve against future clawback; as of June 30, 2010, Fortress held \$39.3 million of such amounts on behalf of employees related to all of the private equity funds.
- (J) Fund I undistributed and distributed incentive income amounts are presented for the total fund, of which Fortress is entitled to approximately 50%. Distributed incentive income subject to clawback for Fund I is presented with respect to Fortress's portion only.
- (K) Represents the portion of a fund's NAV that is eligible to earn incentive income.
- (L) Represents, for those fund investors whose NAV is below the performance threshold Fortress needs to obtain before it can earn incentive income from such investors (their incentive income threshold or high water mark ), the amount by which their aggregate incentive income thresholds exceed their aggregate NAVs. The amount by which the NAV of each investor within this category is below their respective incentive income threshold varies and, therefore, Fortress may begin earning incentive income from certain investors before this entire amount is earned back. Fortress earns incentive income whenever the assets of new investors, as well as of investors whose NAV exceeds their incentive income threshold, increase in value.

**Table of Contents**

**FORTRESS INVESTMENT GROUP LLC**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

- (M) Represents the percentage which is computed by dividing (i) the aggregate NAV of all investors who are at or above their respective incentive income thresholds, by (ii) the total incentive income eligible NAV of the fund. The amount by which the NAV of each fund investor who is not in this category is below their respective incentive income threshold varies, and may vary significantly.
- (N) Represents the amount of additional incentive income Fortress would earn from the fund if it were liquidated at the end of the period at its NAV. This amount is currently subject to performance contingencies generally until the end of the year or, in the case of sidepocket investments, until such investments are realized. Main Fund Investments (Liquidating) pay incentive income only after all capital is returned.
- (O) Represents the amount of incentive income Fortress has earned in the current period from the fund which is no longer subject to contingencies.
- (P) Represents the Drawbridge Global Macro Funds and Fortress Macro Funds. The Drawbridge Global Macro SPV (the "SPV"), which was established in February 2009 to liquidate illiquid investments and distribute the proceeds to then existing investors, is not subject to incentive income and is therefore not presented in the table. However, realized gains or losses within the SPV can decrease or increase, respectively, the gain needed to cross the incentive income threshold for investors with a corresponding investment in the main fund. The impact of the unrealized gains and losses within the SPV at June 30, 2010, as if they became realized, was immaterial to the amounts presented in the table for the Macro main fund.
- (Q) Represents investments held in sidepockets (also known as special investment accounts), which generally have investment profiles similar to private equity funds. The performance of these investments may impact Fortress's ability to earn incentive income from main fund investments. For the credit hedge funds, realized and unrealized losses from individual sidepockets below original cost may reduce the incentive income earned from main fund investments. For the Macro Funds, only realized losses from individual sidepockets reduce the incentive income earned from main fund investments. Based on current unrealized losses in Macro Fund sidepockets, if all of the Macro Fund sidepockets were liquidated at their NAV at June 30, 2010, the undistributed incentive income from the Macro main fund would not be materially impacted.
- (R) Represents investments held in sidepockets for investors with no corresponding investment in the related main fund investments. In the case of the Macro Funds, such investors may have investments in the SPV (see (P) above).
- (S) Includes onshore and offshore funds.
- (T) Relates to accounts where investors have provided return of capital notices and are subject to payout as underlying fund investments are realized.

***Private Equity Funds and Credit PE Funds***

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

During the six months ended June 30, 2010, Fortress formed new private equity funds or credit PE funds which had capital commitments as follows as of June 30, 2010:

Fortress s commitments	\$ 18,010
Fortress s affiliates commitments	23,700
Third party investors commitments	592,255
 Total capital commitments	 \$ 633,965

### *Liquid Hedge Funds and Credit Hedge Funds*

During the six months ended June 30, 2010, Fortress formed, or became the manager of, hedge funds with net asset values as follows as of June 30, 2010:

	Liquid	Credit
Fortress	\$	\$ 102
Fortress s affiliates		
Third party investors		87,205
 Total NAV (A)	 \$	 \$ 87,307

(A) Or other fee paying basis, as applicable.

Redemption notices received, and redemption payments which are made in periods after notices are received, including affiliates, have been as follows:

Six Months Ended June 30,	Liquid Hedge Funds		Credit Hedge Funds	
	Redemption Notices Received	Redemptions Paid During the Period	Redemption Notices Received	Redemptions Paid During the Period
2010	\$ 436,732	\$ 1,153,175	\$ 270,250	\$ 733,532
2009	\$ 1,017,045	\$ 3,427,641	\$ 142,586	\$ 292,884

The differences between notices received and redemptions paid are a result of timing (notices received prior to quarter end, paid afterwards) and the contractual agreements regarding redemptions. In some cases, including all of the credit hedge funds, these agreements allow for delayed payment. In particular, the redemptions within the flagship credit hedge fund in 2008 and 2009, and the redemptions within the flagship liquid hedge fund in the fourth quarter of 2008 which related to illiquid investments, were subject to delayed payment.

---

**Table of Contents**

**FORTRESS INVESTMENT GROUP LLC**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

***Traditional Asset Management***

In February 2010, Fortress announced that certain of its consolidated affiliates had agreed to acquire 100% of the equity of Logan Circle Partners, L.P. ( Logan Circle ) and its general partner, Logan Circle Partners GP, LLC, for approximately \$19 million, with the potential for an additional payment at the end of 2011. The closing of the transaction occurred on April 16, 2010. The additional payment, or contingent consideration, is contingent on the growth and performance of Logan Circle s business (but not contingent on the continued employment of any employees). The contingent consideration is payable in cash or Class A shares, at Fortress s option, and had an estimated fair value of approximately \$4 million at closing (maximum payment of \$28 million). In addition, Fortress may make payments to the prior owners of Logan Circle, contingent upon the settlement of certain liabilities subject to pending litigation, of up to \$2 million as of the date of acquisition. Fortress attributed a nominal fair value to these possible additional payments to the prior owners of Logan Circle. The total purchase price was approximately \$23 million, which has been allocated approximately as follows: \$14 million to goodwill (all expected to be tax deductible), \$8 million to amortizable intangible assets, and \$1 million to miscellaneous net assets.

The goodwill and other intangible assets have been recorded in Other Assets. The intangible assets are being amortized over their estimated useful lives, which range from 1 to 8 years. The contingent consideration is measured at fair value with changes in fair value being recorded as a gain (loss). This fair value is measured based on the expected performance of Logan Circle in 2011 and a discount rate, and therefore is considered a Level 3 valuation (Note 3). No material change in this valuation occurred between April 16, 2010 and June 30, 2010.

As of the date of acquisition, Logan Circle s fair value was approximately equal to its carrying value. Fortress will test the Logan Circle goodwill and other intangible assets for impairment annually in the fourth quarter of each calendar year, or whenever events or circumstances indicate that it is more likely than not that Logan Circle s fair value has declined below its carrying value. Logan Circle s fair value will be estimated based on the following key assumptions: expected retention rate of existing investors, growth expectations, estimated future fee rates, and estimated operating margin. These assumptions are determined primarily based on Logan Circle s past experience, Logan Circle s historical and recent investment performance, current industry trends, and general economic expectations. These assumptions, particularly those relating to investor retention and growth expectations, are highly subjective and are subject to significant uncertainty with respect to future events. Continued challenging credit market conditions could adversely impact the value of Logan Circle.

In connection with the acquisition of Logan Circle, Fortress established a compensation plan for former Logan Circle employees who became employees of Fortress (the Logan Circle Comp Plan ). The Logan Circle Comp Plan is further described in Note 7. From the date of acquisition through June 30, 2010, Logan Circle generated \$3.7 million of revenues (primarily management fees from non-affiliates, recorded in Other Revenues) and \$(4.1) million of net income (loss), including the impact of \$0.1 million of equity-based compensation expense recorded in connection with the Logan Circle Comp Plan. This net income (loss) does not include any change in fair value of the contingent consideration.

Logan Circle is a fixed income asset manager with approximately \$11.4 billion in assets under management as of the date of acquisition. With this acquisition, Fortress has expanded its investment management business to offer fixed income products to investors worldwide. Logan Circle is initially being reported in the unallocated section of Fortress s segments until such time as it becomes material to Fortress s operations.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

**3. INVESTMENTS**

Investments consist primarily of investments in equity method investees and options in these investees. The investees are primarily Fortress Funds.

Investments can be summarized as follows:

	June 30, 2010	December 31, 2009
Equity method investees	\$ 822,885	\$ 809,757
Equity method investees, held at fair value	45,695	56,710
<b>Total equity method investments</b>	<b>868,580</b>	<b>866,467</b>
Options in equity method investees	852	748
<b>Total investments</b>	<b>\$ 869,432</b>	<b>\$ 867,215</b>

Gains (losses) from investments can be summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net realized gains (losses)	\$ (55)	\$ (376)	\$ 345	\$ (772)
Net realized gains (losses) from affiliate investments	(853)	234	(1,182)	(14)
Net unrealized gains (losses)	(637)		(637)	
Net unrealized gains (losses) from affiliate investments	(11,412)	19,583	(10,911)	17,754
<b>Total gains (losses) from investments</b>	<b>\$ (12,957)</b>	<b>\$ 19,441</b>	<b>\$ (12,385)</b>	<b>\$ 16,968</b>

**Investments in Equity Method Investees**

Fortress holds investments in certain Fortress Funds which are recorded based on the equity method of accounting. 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, plus any receivables from such entities as described in Note 6. In addition, unconsolidated affiliates also hold ownership interests in certain of these entities. Summary financial information related to these investments is as follows:

Fortress's Investment June 30,	Fortress's Equity in Net Income (Loss) December 31,
-----------------------------------	--

Edgar Filing: Fortress Investment Group LLC - Form 10-Q

			Three Months Ended		Six Months Ended	
	2010	2009	June 30,		June 30,	
	2010	2009	2010	2009	2010	2009
Private equity funds, excluding NIH (A)	\$ 529,584	\$ 506,383	\$ 7,444	\$ 28,477	\$ 16,686	\$ (3,831)
NIH	2,292	2,486	(32)	123	(181)	(156)
Newcastle (B)	2,749	2,144	N/A	N/A	N/A	N/A
Eurocastle (B)	1,587	2,616	N/A	N/A	N/A	N/A
<b>Total private equity</b>	<b>536,212</b>	<b>513,629</b>	<b>7,412</b>	<b>28,600</b>	<b>16,505</b>	<b>(3,987)</b>
Liquid hedge funds	9,359	12,296	(245)	957	21	1,969
Credit hedge funds	214,572	220,511	2,021	16,490	11,355	14,341
Credit PE funds	103,356	115,896	(3,888)	5,027	(3,936)	3,499
Other	5,081	4,135	850	(17)	2,086	386
	\$ 868,580	\$ 866,467	\$ 6,150	\$ 51,057	\$ 26,031	\$ 16,208

(A) Includes Fortress's direct investment in GAGFAH (XETRA:GFJ) common stock (a private equity portfolio company).

(B) Fortress elected to record these investments, as well as its direct investment in GAGFAH, at fair value pursuant to the fair value option for financial instruments.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

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

	Six Months Ended June 30, 2010								
	Private Equity			Liquid		Credit		Other	Total
	NIH	Other Funds (A)	Castles (B)	Hedge Funds	Hedge Funds	PE Funds			
Investment, beginning	\$ 2,486	\$ 506,383	\$ 4,760	\$ 12,296	\$ 220,511	\$ 115,896	\$ 4,135	\$ 866,467	
Earnings from equity method investees	(181)	16,686	N/A	21	11,355	(3,936)	2,086	26,031	
Other comprehensive income from equity method investees	(13)		N/A			(2,408)		(2,421)	
Contributions to equity method investees		19,427		7,260	934	18,039	50	45,710	
Distributions of earnings from equity method investees		(55)	N/A	(87)	(10)	(3,239)	(685)	(4,076)	
Distributions of capital from equity method investees		(2,267)	N/A	(10,131)	(18,218)	(20,996)	(505)	(52,117)	
Total distributions from equity method investees		(2,322)	N/A	(10,218)	(18,228)	(24,235)	(1,190)	(56,193)	
Mark to fair value - during period (C)	N/A	(3,174)	(64)	N/A	N/A	N/A	N/A	(3,238)	
Translation adjustment		(7,416)	(360)					(7,776)	
Investment, ending	\$ 2,292	\$ 529,584	\$ 4,336	\$ 9,359	\$ 214,572	\$ 103,356	\$ 5,081	\$ 868,580	
Ending balance of undistributed earnings	\$	\$ 1	N/A	\$ 9	\$ 4,523	\$ 1,077	\$ 1,690	\$ 7,300	

(A) Includes Fortress's direct investment in GAGFAH (XETRA:GFJ) common stock (a private equity portfolio company).

(B) Fortress elected to record these investments, as well as its direct investment in GAGFAH, at fair value pursuant to the fair value option for financial instruments.

(C) Recorded to Other Investments - Net Unrealized Gains (Losses) from Affiliate Investments.

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. NIH, the Castles, GAGFAH and Other are not presented as they are insignificant to Fortress's investments.



Edgar Filing: Fortress Investment Group LLC - Form 10-Q

	<i>Private Equity Funds excluding NIH</i>	
	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Assets	\$ 11,115,058	\$ 10,993,214
Debt	(25,432)	(705,432)
Other liabilities	(479,426)	(275,702)
Equity	\$ 10,610,200	\$ 10,012,080
Fortress s Investment (A)	\$ 529,584	\$ 506,383
Ownership (B)	5.0%	5.1%
	<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
Revenues and gains (losses) on investments	\$ 281,058	\$ 824,989
Expenses	(113,672)	(130,114)
Net Income (Loss)	\$ 167,386	\$ 694,875
Fortress s equity in net income (loss)	\$ 16,686	\$ (3,831)

(A) Includes Fortress s direct investment in GAGFAH (XETRA:GFJ) common stock (a private equity portfolio company). GAGFAH s summary financial information is not included in this table.

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

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

	<i>Liquid Hedge Funds</i>		<i>Credit Hedge Funds</i>		<i>Credit PE Funds (B)</i>	
	<b>June 30, 2010</b>	<b>December 31, 2009</b>	<b>June 30, 2010</b>	<b>December 31, 2009</b>	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Assets	\$ 8,943,564	\$ 9,641,111	\$ 11,673,574	\$ 11,048,076	\$ 4,291,561	\$ 6,243,776
Debt			(3,547,439)	(2,938,213)	(454,858)	(1,767,331)
Other liabilities	(4,990,551)	(6,187,965)	(680,012)	(667,604)	(309,668)	(95,807)
Non-controlling interest			(6,055)	(16,600)	(2,511)	(153,016)
<b>Equity</b>	<b>\$ 3,953,013</b>	<b>\$ 3,453,146</b>	<b>\$ 7,440,068</b>	<b>\$ 7,425,659</b>	<b>\$ 3,524,524</b>	<b>\$ 4,227,622</b>
Fortress's Investment	\$ 9,359	\$ 12,296	\$ 214,572	\$ 220,511	\$ 103,356	\$ 115,896
Ownership (A)	0.2%	0.4%	2.9%	3.0%	2.9%	2.7%
	<b>Six Months Ended June 30, 2010</b>	<b>June 30, 2009</b>	<b>Six Months Ended June 30, 2010</b>	<b>June 30, 2009</b>	<b>Six Months Ended June 30, 2010</b>	<b>June 30, 2009</b>
Revenues and gains (losses) on investments	\$ 144,857	\$ 482,313	\$ 672,716	\$ 732,268	\$ 529,609	\$ 729,199
Expenses	(92,714)	(91,392)	(144,641)	(143,270)	(126,775)	(65,007)
<b>Net Income (Loss)</b>	<b>\$ 52,143</b>	<b>\$ 390,921</b>	<b>\$ 528,075</b>	<b>\$ 588,998</b>	<b>\$ 402,834</b>	<b>\$ 664,192</b>
Fortress's equity in net income (loss)	\$ 21	\$ 1,969	\$ 11,355	\$ 14,341	\$ (3,936)	\$ 3,499

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

(B) Includes one entity which is recorded on a one quarter lag (i.e., the balances reflected for this entity are for the periods ended March 31, 2010 and 2009, respectively) and two entities which are recorded on a one month lag. They are recorded on a lag because they are foreign entities and do not provide financial reports under U.S. GAAP within the reporting timeframe necessary for U.S. public entities.

**Investments in Variable Interest Entities**

Fortress is not considered the primary beneficiary of, and, therefore, does not consolidate, any of the variable interest entities in which it holds an interest. No reconsideration events occurred during the six months ended June 30, 2010 which caused a change in Fortress's accounting, except as described below.

The following table sets forth certain information as of June 30, 2010 regarding entities formed during the six months ended June 30, 2010 that were determined to be VIEs in which Fortress holds a variable interest. The amounts presented below are included in, and not in addition to, the equity method investment tables above.

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Business Segment	Gross Assets	Fortress is not Primary Beneficiary		Notes
		Financial Obligations (A)	Fortress Investment (B)	
Credit Hedge Funds	\$ 143,337	\$ 49,887	\$ 168	(C) (D)
Credit PE Funds	\$ 193,807	\$ 46,449	\$ 670	(C)

- (A) Represents financial obligations at the fund level, which are not recourse to Fortress. Financial obligations include financial borrowings, derivative liabilities and short securities. In many cases, these funds have additional debt within unconsolidated subsidiaries. Of the financial obligations represented herein as of June 30, 2010, \$47.4 million and \$46.4 million represent financial borrowings which have weighted average maturities of 30.1 and 3.7 years for the credit hedge funds and credit PE funds, respectively.
- (B) Represents Fortress's maximum exposure to loss with respect to these entities, which includes direct and indirect investments in the funds. In addition to the table above, Fortress is exposed to potential changes in cash flow and revenues attributable to the management fees and/or incentive income Fortress earns from these entities.
- (C) Fortress is not the primary beneficiary of these entities, which represent investing vehicles and a master fund, because the related funds and feeder fund (which are not consolidated) are more closely associated with these funds than Fortress based on both a quantitative and qualitative analysis. The investing vehicles and master fund were formed for the sole purpose of acting as investment vehicles for the related funds.
- (D) Fortress's investment includes \$66,000 of other receivables from the credit hedge funds. In June 2009, the FASB issued new guidance on consolidation which became effective for Fortress on January 1, 2010. This guidance changes the definition of a variable interest entity ( VIE ) and changes the methodology to determine who is the primary beneficiary of, or in other words who consolidates, a VIE. Generally, the changes are expected to cause more entities to be defined as VIE's and to shift consolidation to those entities that exercise day-to-day control over the VIE's, such as investment managers. In February 2010, the FASB updated this guidance to defer its application to certain managed entities, particularly investment companies and similar entities. As a result, this guidance had no material impact on Fortress's financial position, results of operations or liquidity.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

The following table sets forth certain information regarding VIEs in which Fortress held a variable interest. The June 30, 2010 amounts presented below include VIEs formed during the period (as shown in the immediately preceding table) in which Fortress holds a variable interest. The amounts presented below are included in, and not in addition to, the equity method investment tables above.

Business Segment	Fortress is not Primary Beneficiary						
	June 30, 2010			December 31, 2009			
	Gross Assets	Financial Obligations (A)	Fortress Investment (B)	Gross Assets	Financial Obligations (A)	Fortress Investment (B)	Notes
Private Equity Funds	\$ 341,206	\$ 193,497	\$ 2,515	\$ 352,787	\$ 197,791	\$ 2,740	(C) (D)
Castles	9,787,316	10,055,736	12,347	11,150,750	12,066,365	13,335	(C) (D)
Liquid Hedge Funds	7,626,116	4,799,323	6,377	7,773,895	5,090,344	7,170	(C) (D)
Credit Hedge Funds	2,236,956	287,486	13,747	2,153,220	598,216	3,132	(C) (D)
Credit PE Funds	460,352	46,449	1,160	268,919	5,300	3,710	(C) (D)

- (A) Represents financial obligations at the fund level, which are not recourse to Fortress. Financial obligations include financial borrowings, derivative liabilities and short securities. In many cases, these funds have additional debt within unconsolidated subsidiaries. Of the financial obligations represented herein as of June 30, 2010, \$193.4 million, \$9,426.7 million, \$253.0 million and \$46.4 million represent financial borrowings which have weighted average maturities of 0.9, 4.0, 7.9, and 3.7 years for the private equity funds, Castles, credit hedge funds and credit PE funds, respectively. Of the financial obligations represented herein as of December 31, 2009, \$197.8 million, \$11,438.7 million, \$551.4 million, and \$5.3 million represent financial borrowings which have weighted average maturities of 1.4, 4.5, 3.2, and 0.5 years for the private equity funds, Castles, credit hedge funds, and credit PE funds, respectively.
- (B) Represents Fortress's maximum exposure to loss with respect to these entities, which includes direct and indirect investments in these funds. In addition to the table above, Fortress is exposed to potential changes in cash flow and revenues attributable to the management fee and/or incentive income Fortress earns from those entities.
- (C) Fortress is not the primary beneficiary of the Castles and NIH because it does not absorb a majority of their expected income or loss based on a quantitative analysis. Of the remaining entities represented herein, which represent investing vehicles, intermediate entities and master funds, Fortress is not the primary beneficiary because the related funds, intermediate entities and feeder funds (which are not consolidated) are more closely associated with these funds than Fortress based on both a quantitative and qualitative analysis. The investing vehicles, intermediate entities and master funds were formed for the sole purpose of acting as investment vehicles for the related funds.
- (D) As of June 30, 2010, Fortress's investment includes \$3.6 million, \$0.8 million, \$11.4 million, and \$0.2 million of management fees receivable from the Castles, liquid hedge funds, credit hedge funds, and credit PE funds, respectively, as well as \$0.1 million in incentive income receivable from the liquid hedge funds. As of June 30, 2010, Fortress's investment also includes \$0.2 million, \$3.6 million, \$3.7 million and \$1.0 million of expense reimbursements and other receivables from the private equity funds, Castles, liquid hedge funds and credit hedge funds, respectively. As of December 31, 2009, Fortress's investment includes \$4.1 million, \$0.5 million, and \$1.0 million of management fees receivable from the Castles, credit hedge funds, and credit PE funds, respectively, as well as \$3.7 million and \$0.9

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

million in incentive income receivable from the liquid hedge funds and credit hedge funds, respectively. As of December 31, 2009, Fortress's investment also includes \$0.2 million, \$3.7 million, \$1.5 million, \$0.6 million and \$0.7 million of expense reimbursements and other receivables from the private equity funds, Castles, liquid hedge funds, credit hedge funds and credit PE funds, respectively. In addition, Fortress has remaining capital commitments to certain credit PE funds which are VIEs which aggregated \$0.2 million at June 30, 2010.

In March 2010, Fortress determined that a reconsideration event had occurred with respect to an operating subsidiary ( FCF ) of one of its private equity funds. FCF provides operating services to all of Fortress's private equity funds and is reimbursed for related costs by the private equity funds based on a contractual formula. Therefore, FCF by design does not produce net income or have equity. Historically, Fortress has provided temporary advances to FCF as a result of certain funds having insufficient current liquidity to make their required reimbursements on a timely basis; these advances were deemed fully collectable. In March 2010, Fortress determined it would make advances to FCF related to a fund from which reimbursement was subject to significant uncertainty. Management determined that these advances would represent the provision of financial support to FCF. As a result of this reconsideration event, FCF was deemed to be a VIE and Fortress, as a result of directing the operations of FCF through its management contracts with the private equity funds, and providing financial support to FCF beginning in March 2010, was deemed to be its primary beneficiary. Therefore, Fortress consolidated FCF beginning in March 2010, which resulted in a gross up of reimbursement revenues, compensation and miscellaneous expenses, receivables, and payables, but had no impact on Fortress's net income or equity. As of June 30, 2010, FCF's gross assets were approximately \$27.5 million, primarily comprised of affiliate receivables. Fortress's exposure to loss from FCF is limited to its outstanding advances, which were approximately \$10.7 million at June 30, 2010, plus any future advances. Subsequent to Fortress's consolidation of FCF, these advances are eliminated in consolidation. FCF's creditors do not have recourse to Fortress's other assets.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

***Fair Value of Financial Instruments***

The following table presents information regarding Fortress's financial instruments that are recorded at fair value. Investments denominated in foreign currencies have been translated at the period end exchange rate. Changes in fair value are recorded in Gains (Losses) from Investments.

	Fair Value		Valuation Method
	June 30, 2010	December 31, 2009	
<b>Assets</b>			
Newcastle and Eurocastle common shares	\$ 3,032	\$ 2,662	Level 1 - Quoted prices in active markets for identical assets
GAGFAH common shares	\$ 41,359	\$ 51,950	Level 1 - Quoted prices in active markets for identical assets
Eurocastle convertible debt (A)	\$ 1,304	\$ 2,098	Level 3 - Black-Scholes option valuation models, adjusted for non-option characteristics
Newcastle and Eurocastle options	\$ 852	\$ 748	Level 2 - Lattice-based option valuation models using significant observable inputs
<b>Liabilities</b>			
Logan Circle Contingent Consideration	\$ 4,000	\$	Level 3 - Internal model using significant unobservable inputs
Derivatives	\$ 637	\$	Level 2 - See below

(A) The debt bears interest at 20% per annum and is perpetual, but ECT may redeem the securities after June 2011 at a premium of 20%. As of June 30, 2010, it had a face amount of 1.2 million (\$1.5 million) and was convertible into ECT common shares at 0.30 per share. The fair value was determined using the market value approach.

Fortress's interests in instruments measured at fair value using Level 3 inputs changed during the six months ended June 30, 2010 as follows:

	Assets	Liabilities
Balance at December 31, 2009	\$ 2,098	\$
Total gains (losses) included in net income (including foreign currency translation)	(794)	
Issuance of Logan Circle contingent consideration (Note 2)		(4,000)
Balance at June 30, 2010	\$ 1,304	\$ (4,000)

See Note 5 regarding the fair value of Fortress's outstanding debt.

***Derivatives***

Fortress is exposed to certain risks relating to its ongoing business operations. The primary risk managed by Fortress using derivative instruments is foreign currency risk. Fortress enters into foreign exchange forward contracts to economically hedge the risk of fluctuations in foreign exchange rates with respect to certain foreign currency denominated assets. Foreign exchange forward contracts involve the purchase

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

and sale of a designated currency at an agreed upon rate for settlement on a specified date. Fortress entered into four foreign exchange forward contracts in June 2010 which were not designated as hedges for accounting purposes. Gains and losses on these contracts are reported currently in Gains (Losses) from Investments.

Fortress's derivative instruments are carried at fair value and are generally valued using models with observable market inputs that can be verified and which do not involve significant judgment. The significant observable inputs used in determining the fair value of our Level 2 derivative contracts are contractual cash flows and market based parameters such as foreign exchange rates.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

Fortress's derivatives are recorded as follows:

	Balance Sheet Location	Fair Value June 30, 2010	Notional Amount June 30, 2010	Gains/(Losses) Six Months Ended June 30, 2010	Range of Maturity Dates
Foreign Exchange forward contracts (not designated as hedges)	Other Liabilities	(\$ 637)	29,180	(\$ 637)	Sept 2010 - June 2011

**4. DEBT OBLIGATIONS**

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

Debt Obligation	Face Amount and Carrying Value		Contractual Interest Rate	Final Stated Maturity	June 30, 2010	
	June 30, 2010	December 31, 2009			Weighted Average Funding Cost (A)	Weighted Average Maturity (Years)
Credit agreement (B)						
Revolving debt (C)	\$	\$	LIBOR + 2.50% (D)	May 2012		
Term loan	350,000	350,000	LIBOR + 2.50%	May 2012	3.66%	1.67
Delayed term loan (C)	5,900	47,825	LIBOR + 2.50%	May 2012	3.02%	0.29
Total	\$ 355,900	\$ 397,825			3.65%	1.65

(A) The weighted average funding cost is calculated based on the contractual interest rate (utilizing the most recently reset LIBOR rate) plus the amortization of deferred financing costs. The most recently reset LIBOR rate was 0.35%.

(B) 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 interests therein.

(C) Approximately \$66.9 million was undrawn on the revolving debt facility as of June 30, 2010. The revolving debt facility includes a \$25 million letter of credit subfacility of which \$8.1 million was utilized. Lehman Brothers Commercial Paper, Inc., which is committed to fund \$7.2 million (including \$0.8 million of the outstanding letters of credit) of the \$75 million revolving credit facility, has filed for bankruptcy protection, did not fund its pro rata portion of the last borrowing under this facility, and it is reasonably possible that it will not fund its portion of the commitments. As a result, \$60.5 million of the undrawn amount was available.



## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

(D) Subject to unused commitment fees of 0.50% per annum.

To management's knowledge, there have not been any market transactions in Fortress's debt obligations. However, management believes the fair value of this debt was between 95% and 100% of face value at June 30, 2010.

Fortress was in compliance with all of its debt covenants as of June 30, 2010. The following table sets forth the financial covenant requirements as of June 30, 2010 (dollars in millions).

		<b>June 30, 2010</b>		
		(dollars in millions)		
		<b>Requirement</b>	<b>Actual</b>	<b>Notes</b>
AUM		<sup>3</sup> \$ 20,000	\$ 41,660	(A)
Consolidated Leverage Ratio		£ 3.50	1.14	(B)
Required Investment Assets		<sup>3</sup> \$ 366	\$ 871	(C)
Fortress Fund Investments		<sup>3</sup> \$ 147	\$ 545	(C)
Total Investments		<sup>3</sup> \$ 220	\$ 701	(C)

(A) Impacted by capital raised in funds, redemptions from funds, and valuations of fund investments.

(B) Impacted by EBITDA, as defined, which is impacted by the same factors as distributable earnings, except EBITDA is not impacted by changes in clawback reserves or gains and losses, including impairment, on investments.

(C) Impacted by capital investments in funds and the valuation of such funds' investments.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

**5. INCOME TAXES AND TAX RELATED PAYMENTS**

For the six months ended June 30, 2010, an estimated annual effective tax rate of (5.49)% was used to compute the tax provision. Fortress incurred a loss before income taxes for financial reporting purposes, after deducting the compensation expense arising from the Principals forfeiture agreement. However, this compensation expense is not deductible for income tax purposes. Also, a portion of Fortress' s income is not subject to U.S. federal income tax, but is allocated directly to Fortress' s shareholders.

The provision for income taxes consists of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
<b>Current</b>				
Federal income tax expense (benefit)	\$ 2,548	\$ (196)	\$ 2,629	\$ 619
Foreign income tax expense (benefit)	505	580	1,092	992
State and local income tax expense (benefit)	1,417	1,709	3,025	3,834
	4,470	2,093	6,746	5,445
<b>Deferred</b>				
Federal income tax expense (benefit)	1,596	(1,752)	528	(3,271)
Foreign income tax expense (benefit)	28	443	31	347
State and local income tax expense (benefit)	1,540	(2,092)	1,881	(4,236)
	3,164	(3,401)	2,440	(7,160)
Total expense (benefit)	\$ 7,634	\$ (1,308)	\$ 9,186	\$ (1,715)

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

	June 30, 2010	December 31, 2009
Total deferred tax assets	\$ 566,459	\$ 545,253
Valuation allowance	(111,653)	(104,614)
Net deferred tax assets	\$ 454,806	\$ 440,639
Total deferred tax liabilities (A)	\$ 494	\$ 456

(A) Included in Other Liabilities

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

For the six months ended June 30, 2010, a deferred income tax benefit of \$0.5 million was credited to other comprehensive income, primarily related to the equity method investees. A current income tax benefit of \$0.4 million was credited to paid-in capital, related to (i) dividend equivalent payments on RSUs (Note 8), and (ii) distributions to Fortress Operating Group restricted partnership unit holders (Note 7), which are currently deductible for income tax purposes.

The exchange by the principals of Fortress Operating Group units and Class B shares for Class A shares during the second quarter (as described in Note 8) increased FIG Corp's ownership percentage in the underlying Fortress Operating Group entities. As a result of the increased ownership, the deferred tax asset was increased by \$7.2 million with an offsetting increase of \$2.8 million to the valuation allowance. In addition, the deferred tax asset was increased by \$8.0 million related to a step-up in tax basis due to the share exchange which will result in additional tax deductions, while the liability for the tax receivable agreement was increased by \$5.2 million to represent 85% of the expected cash tax savings resulting from the increase in tax basis deductions. The establishment of these net deferred tax assets, net of the change in the tax receivable agreement liability, as well as a \$4.6 million increase to the deferred tax asset relating to the vesting of RSUs, also increased paid-in capital.

### ***Tax Receivable Agreement***

Although the tax receivable agreement payments are calculated based on annual tax savings, for the six months ended June 30, 2010, the payments which would have been made pursuant to the tax receivable agreement, if such period was calculated by itself, were estimated to be \$8.0 million.

In April 2010, \$14.7 million was paid out under the tax receivable agreement related to prior periods.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

**6. RELATED PARTY TRANSACTIONS AND INTERESTS IN CONSOLIDATED SUBSIDIARIES*****Affiliate Receivables and Payables***

Due from affiliates was comprised of the following:

	Private Equity			Credit			Total
	Funds	Castles	Liquid Hedge	Hedge Funds	PE Funds	Other	
<b><u>June 30, 2010</u></b>							
Management fees and incentive income (A)	\$ 38,385	\$ 3,554	\$ 1,014	\$ 17,394	\$ 11,483	\$	\$ 71,830
Expense reimbursements (A)	9,439	3,035	4,149	7,922	4,568		29,113
Expense reimbursements - FCF (B)	16,151						16,151
Dividends and distributions							
Other	48	299		14	13,092	1,696	15,149
Total	\$ 64,023	\$ 6,888	\$ 5,163	\$ 25,330	\$ 29,143	\$ 1,696	\$ 132,243

	Private Equity			Credit			Total
	Funds	Castles	Liquid Hedge Funds	Hedge Funds	PE Funds	Other	
<b><u>December 31, 2009</u></b>							
Management fees and incentive income (C)	\$ 17,116	\$ 4,087	\$ 7,557	\$ 4,038	\$ 11,200	\$	\$ 43,998
Expense reimbursements (C)	5,471	3,750	1,802	4,752	3,010		18,785
Dividends and distributions							
Other	88	179			1	1,460	1,728
Total	\$ 22,675	\$ 8,016	\$ 9,359	\$ 8,790	\$ 14,211	\$ 1,460	\$ 64,511

(A) Net of allowances for uncollectable management fees and expense reimbursements of \$11.3 million and \$0.6 million, respectively.

(B) Represents expense reimbursements due to FCF, a consolidated VIE (Note 3).

(C) Net of allowances for uncollectable management fees and expense reimbursements of \$13.8 million and \$0.8 million, respectively. As of June 30, 2010, amounts due from Fortress Funds recorded in Due from Affiliates included \$38.4 million of past due management fees, excluding \$11.3 million which has been subordinated to other liabilities of the related fund and has been fully reserved by Fortress, and \$10.7 million of private equity general and administrative expenses advanced on behalf of certain Fortress Funds. Although such funds are currently experiencing liquidity issues, Fortress believes the unreserved fees will ultimately be collectable as the NAVs of the respective funds exceed the

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

amounts owed.

Due to affiliates was comprised of the following:

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
<b>Principals</b>		
- Tax receivable agreement - Note 5	\$ 315,794	\$ 326,467
- Distributions payable on Fortress Operating Group units	4,337	16,552
- Distributions payable on other non-controlling interests	23,614	
<b>Other</b>	<b>8,234</b>	<b>2,957</b>
	<b>\$ 351,979</b>	<b>\$ 345,976</b>

### ***Other Related Party Transactions***

For the six months ended June 30, 2010 and 2009, Other Revenues included approximately \$4.0 million and \$3.3 million, respectively, of revenues from affiliates, primarily dividends.

Fortress has entered into cost sharing arrangements with the Fortress Funds, including market data services and subleases of certain of its office space. Expenses borne by the Fortress Funds under these agreements are generally paid directly by those entities (i.e. they are generally not paid by Fortress and reimbursed). For the six months ended June 30, 2010 and 2009, these expenses, mainly related to subscriptions to market data services, approximated \$8.4 million and \$8.5 million, respectively.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

In February 2010, two employees terminated their employment at Fortress in order to form their own management company. Effective April 1, 2010, a subsidiary of Fortress entered into a sub-advisory agreement with them and their management company for the purpose of continuing to have them advise on an existing portfolio of illiquid investments in emerging markets on which they previously worked while they were employees. Pursuant to the terms of the agreement, the subsidiary will pay their management company an annual advisory fee and pay them a percentage of realized net proceeds from certain of such investments. As part of the agreement, the former employees have agreed to notify Fortress about certain investment opportunities in which they are involved. Through June 30, 2010, such payments have aggregated \$0.8 million.

In April 2010, Fortress entered into a software sublicensing agreement on an as is basis with a subsidiary of several Fortress Funds. The software is designed to facilitate cash management, legal entity management and data reconciliation. Fortress paid a one-time licensing fee of \$150,000. The license is perpetual and irrevocable and for the non-exclusive use of Fortress's affiliates.

***Principals and Others Interests in Consolidated Subsidiaries***

These amounts relate to equity interests in Fortress's consolidated, but not wholly owned, subsidiaries, which are held by the Principals, employees and others.

This balance sheet caption was comprised of the following:

	June 30, 2010	December 31, 2009
Principals Fortress Operating Group units	\$ 304,367	\$ 301,469
Employee interests in majority owned and controlled fund advisor and general partner entities	36,651	35,789
Other	1,476	839
Total	\$ 342,494	\$ 338,097

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Principals Fortress Operating Group units	\$ (160,653)	\$ (128,926)	\$ (340,775)	\$ (348,549)
Employee interests in majority owned and controlled fund advisor and general partner entities	1,592	2,183	4,246	2,211
Other	204	5	491	78
Total	\$ (158,857)	\$ (126,738)	\$ (336,038)	\$ (346,260)

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

The purpose of this schedule is to disclose the effects of changes in Fortress's ownership interest in Fortress Operating Group on Fortress's equity:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net income (loss) attributable to Fortress	\$ (92,384)	\$ (44,592)	\$ (176,535)	\$ (111,751)
Transfers (to) from the Principals and Others Interests:				
Increase in Fortress's paid-in capital for the conversion of Fortress Operating Group Units by the Principals	7,188		7,188	
Increase in Fortress's paid-in capital for the delivery of Class A shares primarily in connection with vested RSUs	4,100		7,533	
Decrease in Fortress's paid-in capital for the purchase of Fortress Operating Group units in connection with an equity offering		(144,572)		(144,572)
Change from net income (loss) attributable to Fortress and transfers (to) from Principals and Others Interests	\$ (81,096)	\$ (189,164)	\$ (161,814)	\$ (256,323)

**7. EQUITY-BASED AND OTHER COMPENSATION**

Fortress's total compensation and benefits expense, excluding Principals Agreement compensation, is comprised of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Equity-based compensation, per below	\$ 48,222	\$ 52,779	\$ 112,029	\$ 105,823
Profit-sharing expense, per below	29,020	8,245	79,434	11,849
Discretionary bonuses	44,321	23,290	78,679	46,148
Other payroll, taxes and benefits	37,966	29,142	68,780	58,872
	\$ 159,529	\$ 113,456	\$ 338,922	\$ 222,692

**Equity-Based Compensation**

The following tables set forth information regarding equity-based compensation activities.

	Employees		RSUs		Restricted Shares Issued to Directors		RPUs Employees	
	Number	Value (A)	Number	Value (A)	Number	Value (A)	Number	Value (A)
Outstanding as of December 31, 2009	44,941,811	\$ 14.59	6,689,054	\$ 13.42	216,367	\$ 9.58	31,000,000	\$ 13.75
Issued	7,708,357	4.70	1,004,551	4.70	210,302	3.50		
Converted to Class A shares	(10,528,934)	16.85	(938,390)	13.40				

Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Transfers (C)	5,345,717	12.50	(5,345,717)	12.50				
Forfeited	(1,525,221)	12.84	(212,555)	8.42				
Outstanding as of June 30, 2010 (B)	45,941,730	\$ 12.23	1,196,943	\$ 11.11	426,669	\$ 6.58	31,000,000	\$ 13.75

Expense incurred (B)	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Employee RSUs	\$ 23,175	\$ 24,842	\$ 61,629	\$ 49,265
Non-Employee RSUs	565	3,509	1,815	7,970
Restricted Shares	70	149	161	297
LTIP	1,714	1,714	3,410	3,410
RPU's	22,565	22,565	44,881	44,881
Logan Circle Comp Plan	133		133	
Total equity-based compensation expense	\$ 48,222	\$ 52,779	\$ 112,029	\$ 105,823



**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

(A) Represents the weighted average grant date estimated fair value per share or unit. The weighted average estimated fair value per unit as of June 30, 2010 for awards granted to non-employees was \$2.87, which is equal to the closing trading price per share of Fortress's Class A shares on such date.

(B) In future periods, Fortress will recognize compensation expense on its non-vested equity based awards of \$549 million, with a weighted average recognition period of 2.7 years. This does not include contingent amounts or amounts related to the Principals Agreement.

(C) Relates to FCF employees who became employees of Fortress (see Note 3).

When Fortress records equity-based compensation expense, including that related to the Principals Agreement, it records a corresponding increase in capital. When Fortress delivers Class A shares as a result of the vesting of equity-based compensation, to the extent that it pays withholding taxes in cash (rather than through the sale of employee shares upon delivery) it will record a decrease in capital related to these payments.

In January 2010, Fortress granted 8.0 million RSUs to its employees and affiliates. These RSUs generally vest over two and a half years.

In April 2010, in connection with the acquisition of Logan Circle, Fortress created the Logan Circle Comp Plan (see Note 2). The Logan Circle Comp Plan provides for annual bonuses to a senior employee which may be paid partially in RSUs, as well as for potential Class A share awards to certain employees, including this senior employee, in the years 2015, 2016 and 2017. These awards are annual performance-based awards and depend on the future performance of Logan Circle in the specific years to which they relate. Furthermore, the amounts of RSUs or shares to be awarded are not fixed until the respective year is completed. As such, these awards are expensed in the year to which they pertain based on the estimated value of awards expected to vest in that year.

***Profit Sharing Expense***

Recognized profit sharing compensation expense is summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Private equity funds (A)	\$	\$	\$	\$ (15)
Castles (A)				(137)
Liquid hedge funds	820	2,886	3,846	5,450
Credit hedge funds	4,049	1,765	8,194	2,957
Credit private equity funds	24,151	3,594	67,394	3,594
Total	\$ 29,020	\$ 8,245	\$ 79,434	\$ 11,849

(A) Negative amounts reflect the reversal of previously accrued profit sharing expense resulting from the determination that this expense is no longer probable of being incurred.





Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Fully vested restricted Class A share units with dividend equivalent rights	631,260	631,260	631,260	631,260
Fully vested restricted Class A shares	105,728	105,728	104,404	104,404
Fortress Operating Group units exchangeable into Class A shares (1)		312,071,550		312,071,550
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	115,547,744	427,619,294	105,447,324	417,518,874
<b>Basic and diluted net income (loss) per Class A share</b>				
Net income (loss) attributable to Class A shareholders	\$ (44,592)	\$ (44,592)	\$ (111,751)	\$ (111,751)
Dilution in earnings due to RPU's treated as a participating security of Fortress Operating Group and fully vested restricted Class A share units with dividend equivalent rights treated as outstanding Fortress Operating Group units (4)	(2,052)	(2,052)	(3,729)	(3,729)
Dividend equivalents declared on non-vested restricted Class A shares and restricted Class A share units				
Add back Principals and others interests in loss of Fortress Operating Group, net of assumed corporate income taxes at enacted rates, attributable to Fortress Operating Group units exchangeable into Class A shares (1)		(129,046)		(345,672)
Net income (loss) available to Class A shareholders	\$ (46,644)	\$ (175,690)	\$ (115,480)	\$ (461,152)
Weighted average shares outstanding	115,547,744	427,619,294	105,447,324	417,518,874
Basic and diluted net income (loss) per Class A share	\$ (0.40)	\$ (0.41)	\$ (1.10)	\$ (1.10)

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

- (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. To the extent charges, particularly tax related charges, are incurred by the Registrant (i.e. not at the Fortress Operating Group level), the effect may be anti-dilutive.
- (2) 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 Fortress's Class A shares and therefore participate fully in the results of Fortress's operations from the date they are granted. They are included in the computation of both basic and diluted earnings per Class A share using the two-class method for participating securities, except during periods of net losses.
- (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 in the periods presented, the effect of the units on the calculation is anti-dilutive for each of the periods. The weighted average restricted Class A share units which are not entitled to receive dividend or dividend equivalent payments outstanding were:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Share Units	27,490,829	24,558,303	27,583,603	24,950,597

- (4) Fortress Operating Group RPU's are eligible to receive partnership distribution equivalent payments when distributions are declared and paid on Fortress Operating Group units. The RPU's represent a participating security of Fortress Operating Group and the resulting dilution in Fortress Operating Group earnings available to Fortress is reflected in the computation of both basic and diluted earnings per Class A share using the method prescribed for securities issued by a subsidiary. For purposes of the computation of basic and diluted earnings per Class A share, the fully vested restricted Class A share units with dividend equivalent rights are treated as outstanding Class A shares of Fortress and as outstanding partnership units of Fortress Operating Group.

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 (FOG) 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.

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

	Weighted Average Three Months Ended June 30,		Weighted Average Six Months Ended June 30,	
	2010	2009	2010	2009
Class A shares (public shareholders)	161,432,497	114,810,756	153,795,581	104,711,660
Restricted Class A shares (directors)	270,395	138,160	250,951	136,836
Restricted Class A share units (employees) (A)	3,683,174	631,260	7,466,731	631,260

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Restricted Class A share units (employees) (B)	19,518,811	22,955,132	19,719,641	22,955,132
Fortress Operating Group units (Principals)	300,273,852	312,071,550	304,003,134	312,071,550
Fortress Operating Group RPU's (senior employee)	31,000,000	31,000,000	31,000,000	31,000,000
<b>Total</b>	<b>516,178,729</b>	<b>481,606,858</b>	<b>516,236,038</b>	<b>471,506,438</b>

	<b>As of June 30, 2010</b>	<b>As of December 31, 2009</b>
Class A shares (public shareholders)	164,610,217	145,485,255
Restricted Class A shares (directors)	426,669	216,367
Restricted Class A share units (employees) (A)	779,678	1,174,117
Restricted Class A share units (employees) (B)	19,294,749	25,218,073
Fortress Operating Group units (Principals)	300,273,852	307,773,852
Fortress Operating Group RPU's (senior employee)	31,000,000	31,000,000
<b>Total</b>	<b>516,385,165</b>	<b>510,867,664</b>

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

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

In January 2010, 11.4 million existing RSUs vested and the related Class A shares were delivered within six months of vesting pursuant to the plan documents.

In April 2010, certain Principals exchanged an aggregate of 7,500,000 FOG units and Class B shares for an equal number of Class A shares and simultaneously contributed these shares to a charitable organization.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

Dividends and distributions during the six months ended June 30, 2010 are summarized as follows:

	Declared in Prior Year, Paid Current Year	Declared and Paid	Current Year Declared but not yet Paid	Total
Dividends on Class A Shares	\$	\$	\$	\$
Dividend equivalents on restricted Class A share units (A)				
Distributions to Fortress Operating Group unit holders (Principals) (B)	9,442	28,468	3,931	32,399
Distributions to Fortress Operating Group RPU holders (Note 7) (B)	951	2,867	406	3,273
Total distributions	\$ 10,393	\$ 31,335	\$ 4,337	\$ 35,672

(A) A portion of these dividend equivalents, if any, related to RSUs expected to be forfeited, is included as compensation expense in the consolidated statement of operations and is therefore considered an operating cash flow.

(B) Fortress Operating Group made tax-related distributions to the Principals and RPU holders. In the fourth quarter of 2009, Fortress declared \$16.6 million of such distributions of which \$10.4 million were paid, as reflected in the table, and \$6.2 million were not paid as a result of a change in tax estimates.

The following table summarizes our comprehensive income (loss) (net of taxes) for the six months ended June 30, 2009:

	Impact to Total Fortress Shareholders Equity	Impact to Principals and Others Interests in Equity of Consolidated Subsidiaries	Impact to Total Equity
Net income (loss)	\$ (111,751)	\$ (346,260)	\$ (458,011)
Foreign currency translation	172	584	756
Comprehensive income (loss) from equity method investees	(441)	(1,932)	(2,373)
Total comprehensive income (loss)	\$ (112,020)	\$ (347,608)	\$ (459,628)

**9. COMMITMENTS AND CONTINGENCIES**

Other than as described below, Fortress's commitments and contingencies remain materially unchanged from December 31, 2009.

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

**Private Equity Fund and Credit PE Fund Capital Commitments** Fortress has remaining capital commitments to certain of the Fortress Funds which aggregated \$130.5 million as of June 30, 2010. These commitments can be drawn by the funds on demand.

**Minimum Future Rentals** Fortress is a lessee under a number of operating leases for office space.

Minimum future rent payments under these leases are as follows:

July 1 to December 31, 2010	\$ 9,447
2011	13,292
2012	12,522
2013	11,949
2014	11,031
2015	10,610
Thereafter	12,172
Total	\$ 81,023

Rent expense recognized on a straight-line basis during the six months ended June 30, 2010 and 2009 was \$10.6 million and \$9.8 million, respectively, and was included in General, Administrative and Other Expense.



---

**Table of Contents**

**FORTRESS INVESTMENT GROUP LLC**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

**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, 2010, if any, will not materially affect Fortress's results of operations, liquidity or financial position.

**10. SEGMENT REPORTING**

Fortress conducts its management and investment business through the following six primary segments: (i) private equity funds, (ii) Castles, (iii) liquid hedge funds, (iv) credit hedge funds, (v) credit private equity (PE) funds, and (vi) principal investments in these funds as well as cash that is available to be invested. Logan Circle (Note 2) is initially being reported in the unallocated section of Fortress's segments until such time as it becomes material to Fortress's operations.

Distributable earnings is a measure of operating performance used by management in analyzing its segment and overall results. For the existing Fortress businesses it is equal to net income (loss) attributable to Fortress's Class A shareholders adjusted as follows:

Incentive Income

- (i) a. for Fortress Funds which are private equity funds and credit PE 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 by Fortress's chief operating decision maker as described below (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 private equity funds and credit PE 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,

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

c. subtracting unrealized gains (or adding unrealized losses) on direct investments in publicly traded portfolio companies and in the Castles,

(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,

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

(vi) adding or subtracting, as necessary, any changes in the fair value of contingent consideration payable with respect to the acquisition of a business, to the extent management intends to pay it in equity and it is recorded on the statement of operations under GAAP,

(vii) adding back the amortization of intangible assets and any impairment of goodwill recorded under GAAP,

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

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

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

**Table of Contents**

**FORTRESS INVESTMENT GROUP LLC**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

Fund management DE is equal to distributable earnings excluding investment-related results (specifically, investment income (loss) and interest expense) and is used by management to measure performance of the operating (management) business on a stand-alone basis. Fortress defines its segment operating margin to be equal to fund management DE divided by segment revenues.

Total segment assets 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,
- (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, and
- (iv) the difference, if any, between the GAAP carrying amount of intangible assets and goodwill and their carrying amount for segment reporting purposes resulting from the distributable earnings adjustments listed above.

*Distributable Earnings Impairment*

Investment Impairment for DE purposes

During the six months ended June 30, 2010, Fortress recorded \$4.6 million of impairment on its direct and indirect investments in private equity funds and credit PE funds for segment reporting purposes. This impairment primarily related to declines in the value of investments that were previously impaired. As of June 30, 2010, Fortress had \$0.8 million of unrealized losses on certain investments that have not been recorded as impairment. As of June 30, 2010, Fortress's share of the net asset value of its direct and indirect investments exceeded its segment cost basis by \$155.0 million, representing unrealized gains.

Clawback Reserve on Incentive Income for DE Purposes

Fortress had recognized incentive income for DE purposes from the following private equity and credit PE funds, which are subject to contingent clawback, as of June 30, 2010:

Fund	Net Intrinsic Clawback (A)	Periods in Intrinsic Clawback	Prior Year-End Inception-to-Date Net DE Reserve	Current Year-to-Date Gross DE Reserve	Current Year-to-Date Net DE Reserve	Inception-to-Date Net DE Reserve	Notes
------	-------------------------------------	-------------------------------------	---	--	--	--	-------

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Fund I	N/A	N/A	\$	\$	\$	\$	(B)
Fund II - A	N/A	N/A					(B)
Fund II - B	\$ 6,818	7 Quarters		8,520		8,520	(C)
Fund III	45,108	10 Quarters		45,108		45,108	(D)
FRID	10,041	12 Quarters		10,041		10,041	(D)
Credit Opportunities Fund	N/A	N/A					(B)
FTS SIP L.P.	N/A	N/A					(B)
<b>Total</b>	<b>\$ 61,967</b>		<b>\$</b>	<b>63,669</b>	<b>\$</b>	<b>\$</b>	<b>63,669</b>

(A) See Note 2.

(B) This fund had significant unrealized gains at June 30, 2010. As a result, the CODM determined that no reserve for clawback was required.

(C) The net intrinsic clawback in this fund, after the employee portion, is less than previously recorded reserves. As a result, no further reserve was deemed necessary.

(D) The potential clawback on these funds has been fully reserved in prior periods.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

**Impairment Determination**

Fortress has recorded a total of approximately \$4.6 million of impairment and net reserves for DE purposes on certain investments as described above during the six months ended June 30, 2010. Fortress expects aggregate returns on its other private equity funds and credit PE funds that are in an unrealized investment loss or intrinsic clawback position to ultimately exceed their carrying amount or breakeven point, as applicable. If such funds were liquidated at their June 30, 2010 NAV (although Fortress has no current intention of doing so), the result would be additional impairment losses and reserves for DE purposes of approximately \$0.8 million.

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

**June 30, 2010 and the Six Months Then Ended**

	Private Equity Funds		Liquid Hedge Funds	Credit Hedge Funds		PE Funds	Principal Investments	Unallocated	Fortress Subtotal
Segment revenues									
Management fees	\$ 66,545	\$ 23,978	\$ 38,285	\$ 76,619	\$ 21,314	\$	\$ 3,695	\$ 230,436	
Incentive income			4,247	13,520	131,546			149,313	
Segment revenues - total	\$ 66,545	\$ 23,978	\$ 42,532	\$ 90,139	\$ 152,860	\$	\$ 3,695	\$ 379,749	
Fund management distributable earnings	\$ 49,431	\$ 9,157	\$ 8,813	\$ 29,625	\$ 74,790	\$	\$ (6,705)	\$ 165,111	
Pre-tax distributable earnings	\$ 49,431	\$ 9,157	\$ 8,813	\$ 29,625	\$ 74,790	\$ 4,320	\$ (6,705)	\$ 169,431	
Total segment assets	\$ 77,043	\$ 7,156	\$ 6,521	\$ 24,747	\$ 16,129	\$ 880,173	\$ 564,678	\$ 1,576,447	

(A)

(A) Unallocated assets include deferred tax assets of \$454.8 million.

**Six Months Ended June 30, 2009**

	Private Equity Funds		Liquid Hedge Funds	Credit Hedge Funds		PE Funds	Principal Investments	Unallocated	Fortress Subtotal
Segment revenues									
Management fees	\$ 76,515	\$ 24,430	\$ 42,522	\$ 57,624	\$ 14,435	\$	\$	\$ 215,526	
Incentive income			247	1,013	6,814			8,074	
Segment revenues - total	\$ 76,515	\$ 24,430	\$ 42,769	\$ 58,637	\$ 21,249	\$	\$	\$ 223,600	

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Fund management distributable earnings	\$ 56,856	\$ 10,714	\$ 12,706	\$ 10,371	\$ 6,823	\$	\$	(294)	\$ 97,176
Pre-tax distributable earnings	\$ 56,856	\$ 10,714	\$ 12,706	\$ 10,371	\$ 6,823	\$ (29,114)	\$	(294)	\$ 68,062

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Fund management distributable earnings	\$ 165,111	\$ 97,176
Investment income (loss)	11,694	(13,376)
Interest expense	(7,374)	(15,738)
Pre-tax distributable earnings	169,431	68,062
Adjust incentive income		
Incentive income received from private equity funds and credit PE funds, subject to contingent repayment	\$ (131,546)	\$
Incentive income accrued from private equity funds and credit PE funds, not subject to contingent repayment		
Incentive income received from private equity funds and credit PE funds, not subject to contingent repayment	46,677	
Incentive income from hedge funds, subject to annual performance achievement	(9,731)	(131)
Incentive income received from the sale of shares related to options		
Reserve for clawback, gross (see discussion above)		
	(94,600)	(131)
Adjust other income		
Distributions of earnings from equity method investees**	(8,977)	
Earnings (losses) from equity method investees**	17,250	(1,918)
Gains (losses) on options in equity method investees	104	67
Gains (losses) on other investments	(11,652)	17,687
Incentive income guarantee		
Impairment of investments (see discussion above)	4,641	32,274
Adjust income from the receipt of options		
	1,366	48,110
Adjust employee compensation		
Adjust employee equity-based compensation expense (including Castle options assigned)	(113,035)	(105,823)
Adjust employee portion of incentive income from private equity funds, accrued prior to the realization of incentive income		
Adjust employee portion of incentive income from one private equity fund, not subject to contingent repayment		
	(113,035)	(105,823)
Adjust mark-to-market of contingent consideration in business combination		
Adjust amortization of intangible assets and impairment of goodwill	(359)	
Adjust Principals equity-based compensation expense	(472,126)	(472,126)
Adjust non-controlling interests related to Fortress Operating Group units	340,775	348,549
Adjust tax receivable agreement liability	1,317	(55)
Adjust income taxes	(9,304)	1,663
Total adjustments	(345,966)	(179,813)
Net Income (Loss) Attributable to Class A Shareholders	(176,535)	(111,751)

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Principals and Others	Interests in Income (Loss) of Consolidated Subsidiaries	(336,038)	(346,260)
Net Income (Loss)		\$ (512,573)	\$ (458,011)

\*\* This adjustment relates to all of the Castles, private equity and credit PE Fortress Funds and hedge fund special investment accounts in which Fortress has an investment.



**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

	<b>June 30, 2010</b>
Total segment assets	\$ 1,576,447
Adjust equity investments from cost	113,639
Adjust investments gross of employee portion	48,260
Adjust option investments to intrinsic value	852
Adjust intangible assets to cost	(359)
 Total assets (GAAP)	 \$ 1,738,839

**Three Months Ended June 30, 2010**

	<b>Private Equity</b>		<b>Liquid</b>	<b>Credit</b>		<b>Principal</b>		<b>Fortress</b>
	<b>Funds</b>	<b>Castles</b>	<b>Hedge</b>	<b>Hedge</b>	<b>PE</b>	<b>Investments</b>	<b>Unallocated</b>	<b>Subtotal</b>
			<b>Funds</b>	<b>Funds</b>	<b>Funds</b>			
Segment revenues								
Management fees	\$ 33,293	\$ 11,439	\$ 19,483	\$ 43,517	\$ 11,157	\$	\$ 3,695	\$ 122,584
Incentive income			(1,255)	5,199	46,396			50,340
 Segment revenues - total	 \$ 33,293	 \$ 11,439	 \$ 18,228	 \$ 48,716	 \$ 57,553	 \$	 \$ 3,695	 \$ 172,924
 Fund management distributable earnings	 \$ 24,869	 \$ 4,720	 \$ 1,001	 \$ 18,863	 \$ 28,989	 \$	 \$ (5,475)	 \$ 72,967
 Pre-tax distributable earnings	 \$ 24,869	 \$ 4,720	 \$ 1,001	 \$ 18,863	 \$ 28,989	 \$ 71	 \$ (5,475)	 \$ 73,038

**Three Months Ended June 30, 2009**

	<b>Private Equity</b>		<b>Liquid</b>	<b>Credit</b>		<b>Principal</b>		<b>Fortress</b>
	<b>Funds</b>	<b>Castles</b>	<b>Hedge</b>	<b>Hedge</b>	<b>PE</b>	<b>Investments</b>	<b>Unallocated</b>	<b>Subtotal</b>
			<b>Funds</b>	<b>Funds</b>	<b>Funds</b>			
Segment revenues								
Management fees	\$ 38,884	\$ 12,519	\$ 19,893	\$ 29,501	\$ 8,354	\$	\$	\$ 109,151
Incentive income			247	191	6,814			7,252
 Segment revenues - total	 \$ 38,884	 \$ 12,519	 \$ 20,140	 \$ 29,692	 \$ 15,168	 \$	 \$	 \$ 116,403
 Fund management distributable earnings	 \$ 27,567	 \$ 6,725	 \$ 6,731	 \$ 7,467	 \$ 4,590	 \$	 \$ (143)	 \$ 52,937
 Pre-tax distributable earnings	 \$ 27,567	 \$ 6,725	 \$ 6,731	 \$ 7,467	 \$ 4,590	 \$ 5,920	 \$ (143)	 \$ 58,857



**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009
Fund management distributable earnings	\$ 72,967	\$ 52,937
Investment income (loss)	3,693	13,533
Interest expense	(3,622)	(7,613)
Pre-tax distributable earnings	73,038	58,857
Adjust incentive income		
Incentive income received from private equity funds and credit PE funds, subject to contingent repayment	\$ (46,396)	\$
Incentive income accrued from private equity funds and credit PE funds, not subject to contingent repayment		
Incentive income received from private equity funds and credit PE funds, not subject to contingent repayment	28,733	
Incentive income from hedge funds, subject to annual performance achievement	(3,448)	(131)
Incentive income received from the sale of shares related to options		
Reserve for clawback, gross (see discussion above)		
	(21,111)	(131)
Adjust other income		
Distributions of earnings from equity method investees**	(3,201)	
Earnings (losses) from equity method investees**	4,651	37,004
Gains (losses) on options in equity method investees	(452)	43
Gains (losses) on other investments	(11,594)	19,540
Incentive income guarantee		
Impairment of investments (see discussion above)	297	
Adjust income from the receipt of options		
	(10,299)	56,587
Adjust employee compensation		
Adjust employee equity-based compensation expense (including Castle options assigned)	(49,229)	(52,779)
Adjust employee portion of incentive income from private equity funds, accrued prior to the realization of incentive income		
Adjust employee portion of incentive income from one private equity fund, not subject to contingent repayment		
	(49,229)	(52,779)
Adjust mark-to-market of contingent consideration in business combination		
Adjust amortization of intangible assets and impairment of goodwill	(359)	
Adjust Principals equity-based compensation expense	(237,367)	(237,367)
Adjust non-controlling interests related to Fortress Operating Group units	160,653	128,926
Adjust tax receivable agreement liability		
Adjust income taxes	(7,710)	1,315
Total adjustments	(165,422)	(103,449)

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Net Income (Loss) Attributable to Class A Shareholders	(92,384)	(44,592)
Principals and Others Interests in Income (Loss) of Consolidated Subsidiaries	(158,857)	(126,738)
Net Income (Loss)	\$ (251,241)	\$ (171,330)

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

**Reconciling items between segment measures and GAAP measures:**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Segment revenues	\$ 172,924	\$ 116,403	\$ 379,749	\$ 223,600
Adjust management fees*	(3,406)	163	(2,121)	325
Adjust incentive income	(21,111)	(131)	(94,600)	(131)
Adjust income from the receipt of options				
Other revenues*				
Adjust management fees from non-affiliates	(6,284)	(889)	(8,885)	(1,774)
Adjust incentive income from non-affiliates	(380)	(163)	(8,308)	(985)
Adjust other revenues (including expense reimbursements)	49,587	23,704	85,683	40,348
	42,923	22,652	68,490	37,589
Total revenues (GAAP)	\$ 191,330	\$ 139,087	\$ 351,518	\$ 261,383

\* Segment revenues do not include GAAP other revenues, except to the extent they represent management fees or incentive income; such revenues are included elsewhere in the calculation of distributable earnings.

Fortress's depreciation and amortization expense by segment was as follows. Amortization expense, related to intangible assets, is not a component of distributable earnings.

	Private Equity		Liquid	Credit				
	Funds	Castles	Hedge Funds	Hedge Funds	PE Funds	Unallocated	Total	
Three Months Ended June 30, 2010								
Depreciation	\$ 486	\$ 100	\$ 365	\$ 812	\$ 210	\$ 962	\$ 2,935	
Amortization						359	359	
Total	\$ 486	\$ 100	\$ 365	\$ 812	\$ 210	\$ 1,321	\$ 3,294	
2009								
Depreciation	\$ 284	\$ 131	\$ 531	\$ 710	\$ 131	\$ 974	\$ 2,761	
Amortization								
Total	\$ 284	\$ 131	\$ 531	\$ 710	\$ 131	\$ 974	\$ 2,761	

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Six Months Ended June 30,  
2010

Depreciation	\$ 764	\$ 215	\$ 750	\$ 1,646	\$ 420	\$ 1,822	\$ 5,617
Amortization						359	359

Total	\$ 764	\$ 215	\$ 750	\$ 1,646	\$ 420	\$ 2,181	\$ 5,976
-------	--------	--------	--------	----------	--------	----------	----------

2009

Depreciation	\$ 568	\$ 300	\$ 1,142	\$ 1,406	\$ 238	\$ 1,748	\$ 5,402
Amortization							

Total	\$ 568	\$ 300	\$ 1,142	\$ 1,406	\$ 238	\$ 1,748	\$ 5,402
-------	--------	--------	----------	----------	--------	----------	----------

### 11. SUBSEQUENT EVENTS

These financial statements include a discussion of material events, if any, which have occurred subsequent to June 30, 2010 (referred to as subsequent events ) through the issuance of these consolidated financial statements. Events subsequent to that date have not been considered in these financial statements.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

**12. CONSOLIDATING FINANCIAL INFORMATION**

The consolidating financial information presents the balance sheet, statement of operations and statement of cash flows for Fortress Operating Group (on a combined basis) and Fortress Investment Group LLC (including its consolidated subsidiaries other than those within Fortress Operating Group) on a deconsolidated basis, as well as the related eliminating entries for intercompany balances and transactions, which sum to Fortress Investment Group's consolidated financial statements as of, and for the six months ended, June 30, 2010.

Fortress Operating Group includes all of Fortress's operating and investing entities. The upper tier Fortress Operating Group entities are the obligors on Fortress's credit agreement (Note 4). Segregating the financial results of this group of entities provides a more transparent view of the capital deployed in Fortress's businesses and the relevant ratios for borrowing entities.

The consolidating balance sheet information is as follows:

	As of June 30, 2010			
	Fortress Operating Group Combined	Fortress Investment Group LLC Consolidated (A)	Intercompany Eliminations	Fortress Investment Group LLC Consolidated
<b>Assets</b>				
Cash and cash equivalents	\$ 167,022	\$ 505	\$	\$ 167,527
Due from affiliates	132,243	4,567	(4,567)	132,243
Investments	869,432	166,838	(166,838)	869,432
Deferred tax asset	12,623	442,183		454,806
Other assets	106,586	8,245		114,831
	\$ 1,287,906	\$ 622,338	\$ (171,405)	\$ 1,738,839
<b>Liabilities and Equity</b>				
<b>Liabilities</b>				
Accrued compensation and benefits	\$ 101,413	\$	\$	\$ 101,413
Due to affiliates	40,752	315,794	(4,567)	351,979
Deferred incentive income	244,966			244,966
Debt obligations payable	355,900			355,900
Other liabilities	35,543			35,543
	778,574	315,794	(4,567)	1,089,801
<b>Commitments and Contingencies</b>				
<b>Equity</b>				
Paid-in capital	3,609,560	1,252,148	(3,609,560)	1,252,148
Retained earnings (accumulated deficit)	(3,130,916)	(944,529)	3,130,916	(944,529)
Accumulated other comprehensive income (loss)	(7,439)	(1,075)	7,439	(1,075)
Total Fortress shareholders' equity (B)	471,205	306,544	(471,205)	306,544

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Principals and others interests in equity of consolidated subsidiaries	38,127		304,367	342,494
<b>Total Equity</b>	<b>509,332</b>	<b>306,544</b>	<b>(166,838)</b>	<b>649,038</b>
	\$ 1,287,906	\$ 622,338	\$ (171,405)	\$ 1,738,839

(A) Other than Fortress Operating Group.

(B) Includes the Principals members equity in the Fortress Operating Group column, which is eliminated in consolidation.



**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

The consolidating statement of operations information is as follows:

	Six Months Ended June 30, 2010			
	Fortress Operating Group Consolidated	Fortress Investment Group LLC Consolidated (A)	Intercompany Eliminations	Fortress Investment Group LLC Consolidated
<b>Revenues</b>				
Management fees from affiliates	\$ 219,430	\$	\$	\$ 219,430
Incentive income from affiliates	46,405			46,405
Expense reimbursements from affiliates	63,861			63,861
Other revenues	21,825	2	(5)	21,822
	351,521	2	(5)	351,518
<b>Expenses</b>				
Interest expense	7,375	124	(5)	7,494
Compensation and benefits	338,922			338,922
Principals agreement compensation	472,126			472,126
General, administrative and other	45,349	1		45,350
Depreciation and amortization	5,976			5,976
	869,748	125	(5)	869,868
<b>Other Income (Loss)</b>				
Gains (losses) from investments	(12,385)			(12,385)
Tax receivable agreement liability adjustment		1,317		1,317
Earnings (losses) from equity method investees	26,031	(172,052)	172,052	26,031
	13,646	(170,735)	172,052	14,963
<b>Income (Loss) Before Income Taxes</b>	(504,581)	(170,858)	172,052	(503,387)
Income tax benefit (expense)	(3,509)	(5,677)		(9,186)
<b>Net Income (Loss)</b>	\$ (508,090)	\$ (176,535)	\$ 172,052	\$ (512,573)
<b>Principals and Others Interests in Income (Loss) of Consolidated Subsidiaries</b>	\$ 4,737	\$	\$ (340,775)	\$ (336,038)
<b>Net Income (Loss) Attributable to Class A Shareholders (B)</b>	\$ (512,827)	\$ (176,535)	\$ 512,827	\$ (176,535)

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

(A) Other than Fortress Operating Group.

(B) Includes net income (loss) attributable to the Principals' interests in the Fortress Operating Group column, which is eliminated in consolidation.

**Table of Contents****FORTRESS INVESTMENT GROUP LLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

JUNE 30, 2010

(dollars in tables in thousands, except share data)

The consolidating statement of cash flows information is as follows:

	<b>Fortress Operating Group Consolidated</b>	<b>Six Months Ended June 30, 2010</b>		<b>Fortress Investment Group LLC Consolidated</b>
		<b>Fortress Investment Group LLC Consolidated (A)</b>	<b>Intercompany Eliminations</b>	
<b>Cash Flows From Operating Activities</b>				
Net income (loss)	\$ (508,090)	\$ (176,535)	\$ 172,052	\$ (512,573)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities				
Depreciation and amortization	5,976			5,976
Other amortization and accretion	1,678			1,678
(Earnings) losses from equity method investees	(26,031)	172,052	(172,052)	(26,031)
Distributions of earnings from equity method investees	4,076			4,076
(Gains) losses from investments	12,385			12,385
Deferred incentive income	(46,677)			(46,677)
Deferred tax (benefit) expense	787	1,653		2,440
Tax receivable agreement liability adjustment		(1,317)		(1,317)
Equity-based compensation	584,155			584,155
Allowance for doubtful accounts	(2,447)			(2,447)
Other	1,005			1,005
Cash flows due to changes in				
Due from affiliates	(67,975)	(1,857)	1,857	(67,975)
Other assets	(146)	984		838
Accrued compensation and benefits	21,640			21,640
Due to affiliates	7,633	(15,122)	(1,857)	(9,346)
Deferred incentive income	131,546			131,546
Other liabilities	(1,397)			(1,397)
Net cash provided by (used in) operating activities	118,118	(20,142)		97,976
<b>Cash Flows From Investing Activities</b>				
Contributions to equity method investees	(31,694)	(50,941)	50,941	(31,694)
Distributions of capital from equity method investees	46,124	18,440	(18,440)	46,124
Purchase of fixed assets	(1,522)			(1,522)
Acquisitions, net of cash received	(13,474)			(13,474)
Net cash provided by (used in) investing activities	(566)	(32,501)	32,501	(566)
<b>Cash Flows From Financing Activities</b>				
Repayments of debt obligations	(41,925)			(41,925)
Payment of deferred financing costs				
Issuance (purchase) of Class A shares (RSU settlements)	(50,941)	50,941		

Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Capital contributions (distributions)	50,941		(50,941)	
Dividends and dividend equivalents paid	(60,168)		60,168	
Principals and others interests in equity of consolidated subsidiaries - contributions	56			56
Principals and others interests in equity of consolidated subsidiaries - distributions	(43,385)		(41,728)	(85,113)
Net cash provided by (used in) financing activities	(145,422)	50,941	(32,501)	(126,982)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	(27,870)	(1,702)		(29,572)
<b>Cash and Cash Equivalents, Beginning of Period</b>	194,892	2,207		197,099
<b>Cash and Cash Equivalents, End of Period</b>	\$ 167,022	\$ 505	\$	\$ 167,527

(A) Other than Fortress Operating Group.

---

## **Table of Contents**

### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

(tables in thousands except as otherwise indicated and per share data)

*The following discussion should be read in conjunction with Fortress Investment Group's consolidated financial statements and the related notes (referred to as consolidated financial statements or historical consolidated financial statements) included within this Quarterly Report on Form 10-Q. This discussion contains forward-looking statements that are subject to known and unknown risks and uncertainties. Actual results and the timing of events may differ significantly from those expressed or implied in such forward-looking statements due to a number of factors, including those included in Part II, Item 1A, Risk Factors and elsewhere in this Quarterly Report on Form 10-Q.*

#### **General**

##### *Our Business*

Fortress is a leading global investment manager with approximately \$41.7 billion in AUM as of June 30, 2010. Fortress offers a range of alternative and traditional investment strategies for institutional and private investors around the world. We earn management fees based on the amount of capital we manage, incentive income based on the performance of our alternative investment funds, and investment income (loss) from our principal investments. We invest capital in each of our alternative investment businesses.

As of June 30, 2010, we managed alternative assets in three core businesses:

**Private Equity** a business that manages approximately \$14.4 billion of AUM comprised of two business segments: (i) private equity funds that primarily make significant, control-oriented investments in debt and equity securities of public or privately held entities in North America and Western Europe, with a focus on acquiring and building asset-based businesses with significant cash flows; and (ii) publicly traded alternative investment vehicles, which we refer to as Castles, that invest primarily in real estate and real estate related debt investments.

**Liquid Hedge Funds** a business that manages approximately \$4.2 billion of AUM. These funds invest globally in fixed income, currency, equity and commodity markets and related derivatives to capitalize on imbalances in the financial markets.

**Credit Funds** a business that manages approximately \$11.6 billion of AUM comprised of two business segments: (i) credit hedge funds which make highly diversified investments in assets, opportunistic lending situations and securities on a global basis and throughout the capital structure, with a value orientation, as well as in investment funds managed by external managers, which include non-Fortress originated funds for which Fortress has been retained as manager as part of an advisory business; and (ii) credit private equity (PE) funds which are comprised of a family of credit opportunities funds focused on investing in distressed and undervalued assets, a family of long dated value funds focused on investing in undervalued assets with limited current cash flows and long investment horizons, a family of real assets funds focused on investing in tangible and intangible assets in four principal categories (real estate, capital assets, natural resources and intellectual property), and an Asian fund.

In addition, we treat our principal investments in these funds as a distinct business segment and we do not treat our traditional asset management business, which has \$11.5 billion of AUM, as a separate segment until such time as its operations become significant.

#### **Balance Sheet**

Our assets consist primarily of the following:

- 1) Investments in our funds, recorded generally based on our share of the funds underlying net asset value, which in turn is based on the estimated fair value of the funds investments.
- 2) Cash.
- 3) Amounts due from our funds for fees and reimbursements.

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

- 4) Deferred tax assets, which relate to potential future tax benefits. This asset is not tangible it was not paid for and does not represent a receivable or other claim on assets.

Our liabilities consist primarily of the following:

- 1) Debt owed under our credit facility.
- 2) Accrued compensation, generally payable to employees shortly after year-end.
- 3) Amounts due to our Principals under the tax receivable agreement. These amounts partially offset the deferred tax assets and do not become payable to the Principals until the related future tax benefits are realized.

**Table of Contents**

4) Deferred incentive income, which is incentive income that we have already received in cash but is subject to contingencies and may have to be returned ( clawed back ) to the respective funds if certain performance hurdles are not met.  
Management, in considering the liquidity and health of the company, mainly focuses on the following aspects of the balance sheet:

- 1) Expected cash flows from funds, including the potential for incentive income.
- 2) Cash on hand.
- 3) Collectability of receivables.
- 4) Current amounts due under our credit facility.
- 5) Other current liabilities, primarily accrued compensation.
- 6) Debt covenants, including the ratio of investment assets to debt.
- 7) Likelihood of clawback of incentive income.

**Income Statement**

Our revenues consist primarily of the following:

- 1) Fees and reimbursements from our funds, including management fees, which are based on the size of the funds, and incentive income, which is based on the funds performance.
- 2) Returns on our investments in the funds.

Our expenses consist primarily of the following:

- 1) Employee compensation paid in cash.
- 2) Equity-based compensation, which is not paid in cash but has a dilutive effect when it vests because it results in additional shares being issued. (This amount is broken out from total compensation in the compensation footnote in our consolidated financial statements.)
- 3) Principals agreement compensation, which has no economic effect on us and is not considered by management in assessing our performance.

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

4) Other general and administrative expenses and interest.

5) Taxes.

The primary measure of operating performance used by management is Distributable Earnings, which is further discussed in the Segment Analysis section herein.

Essentially, the key components of our income are the fees we are earning from our funds in comparison to the compensation and other corporate expenses we are paying in cash, and the resulting operating margin. Other significant components include (i) the unrealized changes in value of our funds, reported as unrealized gains (losses) and earnings (losses) from equity method investees, as this is indicative of changes in potential future cash flows, (ii) taxes, and (iii) equity-based compensation (not including principals agreement compensation), because it will eventually have a dilutive effect when the related shares are issued to employees.

### *Managing Business Performance*

We conduct our management and investment business through the following primary segments: (i) private equity funds, (ii) Castles, (iii) liquid hedge funds, (iv) credit hedge funds, (v) credit private equity ( PE ) funds, and (vi) principal investments in those funds, as well as cash that is available to be invested. These segments are differentiated based on the varying strategies of the funds we manage in each segment.

The amounts not allocated to a segment consist primarily of certain general and administrative expenses. Where applicable, portions of the general and administrative expenses have been allocated between the segments. Logan Circle (see Note 2 to the consolidated financial statements included herein) is initially being reported in the unallocated section of our segments until such time as it becomes material to our operations.

Management assesses our 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.



---

## **Table of Contents**

Management assesses the net performance of each segment based on its distributable earnings. Distributable earnings is not a measure of cash generated by operations that is available for distribution. Rather distributable earnings is a supplemental measure of operating performance used by management in analyzing its segment and overall results. Distributable earnings should not be considered as an alternative to cash flow in accordance with GAAP or as a measure of our liquidity, and is not necessarily indicative of cash available to fund cash needs (including dividends and distributions).

We believe that the presentation of distributable earnings enhances a reader's understanding of the economic operating performance of our segments. For a more detailed discussion of distributable earnings and how it reconciles to our GAAP net income (loss), see Results of Operations Segments Analysis below.

## **Market Considerations**

Our revenues consist primarily of (i) management fees based generally on the size of our funds, (ii) incentive income based on the performance of our funds and (iii) investment income from our investments in those funds. Our ability to maintain and grow our revenues both at Fortress and within our funds depends on our ability to retain existing investors, attract new capital and investors, secure investment opportunities, obtain financing for transactions, consummate investments and deliver attractive risk-adjusted returns. Our ability to execute this investment strategy depends upon a number of market conditions, including:

*The strength and liquidity of U.S. and global financial institutions and the financial system.*

While market conditions in the United States and abroad have generally improved over the last several quarters, it is not clear whether a sustained recovery will occur or, if so, for how long it will last. Concerning developments in the global capital markets during the first half of 2010 have renewed concerns among many market participations about the health of the financial markets and the financial institutions and countries that participate in these markets. We and other market participants face uncertain conditions, a reduced universe of counterparties (and attendant increased counterparty risk) and continued challenges in addressing the issues created by the recent challenging credit and liquidity conditions and financial institution failures. If market conditions remain challenging or deteriorate in the future particularly if there is another failure of one or more major financial institutions, a default or serious deterioration in the financial condition of one or more sovereign nations, or another severe contraction of available debt or equity capital, this development would negatively impact Fortress or one or more of our funds.

*The strength and liquidity of the U.S. and global equity and debt markets.*

Strong equity market conditions enable our private equity funds to increase the value, and effect realizations, of their portfolio company investments. In addition, strong equity markets make it generally easier for our funds that invest in equities to generate positive investment returns. The condition of debt markets also has a meaningful impact on our business. Several of our funds make investments in debt instruments, which are assisted by a strong and liquid debt market. In addition, our funds borrow money to make investments. Our funds utilize leverage in order to increase investment returns, which ultimately drive the performance of our funds. Furthermore, we utilize debt to finance our investments in our funds and for working capital purposes.

Debt market conditions began to deteriorate in mid-2007, as the United States experienced considerable turbulence in the housing and sub-prime mortgage markets, which negatively affected other fixed income markets. The difficult conditions in the fixed income markets prompted lenders to cease committing to new senior loans and other debt, which, in turn, made it extremely difficult to finance new and pending private equity acquisitions or to refinance existing debt. In particular, the securitization markets, which in years prior to 2007 had represented an important outlet for the placing of acquisition debt, have been essentially shut down or severely impaired since that time. Private equity-led acquisitions announced since mid-2007 have generally been smaller, less levered, and subject to more restrictive debt covenants than acquisitions done prior to the disruption.

As the turbulence continued and its intensity increased, equity market conditions also began to deteriorate in the latter part of 2007 as concerns of an economic slowdown began to affect equity valuations. The resulting reduction in liquidity and increase in volatility caused several commercial and investment banks, hedge funds and other financial institutions to reduce the carrying value of a significant amount of their fixed income holdings, which further reduced the liquidity of debt and, to a lesser extent, equity instruments. Equity market conditions have shown initial signs of stabilizing during most of 2009, and we were able to successfully access the equity markets in the United States and abroad during 2009 (including, for example, our IPO of Rail America in late 2009). That said, the U.S. and global equity markets remain somewhat constricted, and we cannot predict the future conditions of these markets or the impact of such conditions on our business.



## Table of Contents

The current market conditions have negatively impacted our business in several ways:

While conditions in the U.S. capital markets have begun to recently improve, there currently is less debt and equity capital available in the market relative to the levels available in years prior to 2008, which, coupled with additional margin collateral requirements imposed by lenders on some types of investments, debt and derivatives, has increased the importance of maintaining sufficient liquidity without relying upon additional infusions of capital from the debt and equity markets. Based on cash balances, committed financing and short-term operating cash flows, in the judgment of management we have sufficient liquidity in the current market environment. However, maintaining this liquidity rather than investing available capital, and the reduced availability of attractive financing, has reduced our returns. This, in turn, may limit our ability to make investments, distributions, or engage in other strategic transactions. The dislocation of values and associated decreased liquidity in the global equity and debt markets have caused a material depreciation in equity and fixed income asset values, greater price volatility and weaker economic conditions around the globe. This has resulted in a significant reduction in the value of our investments, which in turn impacts our management fees, incentive income and investment income as described below. In recent months, such values have rebounded, but have not increased to their historical levels.

There has been a prolonged reduction in market trading activity in certain market sectors. This reduction and concern over market conditions have resulted in significant reductions in valuations by third party brokers and pricing agents, and in difficulty in obtaining price quotes for less actively traded instruments.

The market prices of the investments held by our private equity funds and credit PE funds in public companies decreased substantially from their high values, rebounded meaningfully in 2009 and early 2010, but declined somewhat in the second quarter of 2010. A decrease in these prices hinders our ability to realize gains within these funds and therefore our ability to earn incentive income. Furthermore, the disruptions in the debt and equity markets have made exit strategies for private investments more difficult to execute as potential buyers have difficulty obtaining attractive financing and the demand for IPOs has been greatly reduced. Although we successfully executed an IPO of one of our private equity portfolio companies in October 2009, the overall volume of IPO transactions (particularly of private equity-backed companies) has continued to be significantly lower than in prior years and execution risk for such transactions remains higher.

These conditions have made it more difficult to generate positive investment returns and have contributed to increased redemption requests from investors throughout the hedge fund industry. A number of our funds have been affected by this trend in prior periods, but this trend decelerated somewhat in 2009 and early 2010.

As a result of the above factors:

We have not paid a dividend on our Class A shares since the second quarter of 2008. The decision to pay a dividend, as well as the amount of any dividends paid, is subject to change at the discretion of our board of directors based upon a number of factors, including actual and projected distributable earnings. If current conditions persist or deteriorate, we may be unable to pay any dividends.

Our share of the NAV of certain fund investments, including certain investments on which we have received incentive returns, has declined below their related carrying amounts for distributable earnings purposes. During the six months ended June 30, 2010, we have taken \$4.6 million of impairments and net reserves related to such funds for distributable earnings purposes. Declines in the NAV of our fund investments have also caused us to record GAAP losses from equity method investees in prior periods, although we have recorded net GAAP income from such investments in 2009 and the first six months of 2010. Furthermore, such declines impact our future management fees, generally at an annual rate of between 1% - 3% of the decline in aggregate fund NAV. See [Fee Paying Assets Under Management](#) below for a table summarizing our AUM.

Our liquid and credit hedge funds received a total of \$0.4 billion and \$0.3 billion in redemption and return of capital requests, respectively, including affiliates, for the six months ended June 30, 2010. These redemptions will directly impact the management fees we receive in 2010 from such funds (which pay management fees of between 1.5% - 2% of AUM). Investors in our credit hedge funds are permitted to request that their capital be returned on an annual basis. With respect to capital returns requested in 2008 and 2009, such returns of capital are generally being paid over time as the underlying investments are liquidated. During this period, such amounts continue to be subject to management fees and, as applicable, incentive income. Future return of capital requests may be paid immediately or over time, in accordance with the governing documents of the applicable funds. The 2010 return of capital notice dates for Fortress's flagship credit hedge fund and for the Fortress Partners Fund had not yet occurred as of June 30, 2010.

In previous periods, we disclosed that the NAVs of most of our investors in our main credit and liquidity hedge funds were below their incentive income thresholds (high water marks). As a result of recent improved performance, the incentive income outlook for these funds has substantially improved. See Note 2 to the consolidated financial statements included herein for more information. Returns earned on capital from new investors continue to be incentive income eligible. Unrealized losses in a significant portion of our private equity funds have resulted in higher future returns being required before we earn incentive income from such funds. The returns required are subject to a number of variables including: the amount of loss incurred, the amount of outstanding capital in the fund, the amount and timing of future capital draws and distributions, the rate of preferential return earned by investors, and others.

---

**Table of Contents**

During 2008 and 2009, the public company was more focused on preserving capital and liquidity at the public company level than on making investments at the public company level. As market conditions, as well as the company's liquidity and leverage levels, improved during 2009, the company has renewed efforts to explore making investments at the public company level. On February 16, 2010, the public company announced that certain of its consolidated affiliates have agreed to acquire Logan Circle Partners, L.P. ( Logan Circle ) and its general partner, Logan Circle Partners GP, LLC, for approximately \$19 million (subject to certain adjustments), with the potential for an additional payment at the end of 2011, contingent on the growth and performance of Logan Circle's business. The transaction closed on April 16, 2010. Logan Circle is a fixed income asset manager with approximately \$11.4 billion in assets under management at closing.

Our funds continue to make investments on an opportunistic basis, and we continue to raise new funds as illustrated in the AUM table below.

*The strength of, and competitive dynamics within, the alternative asset management industry, including the amount of capital invested in, and withdrawn from, alternative investments.*

The strength of the alternative asset management industry, and our competitive strength relative to our peers, are dependent upon several factors, including, among other things, (1) the investment returns alternative asset managers can provide relative to other investment options, (2) the amount of capital investors allocate to alternative asset managers, and (3) our performance relative to our competitors and the related impact on our ability to attract new capital.

First, the strength of the alternative asset management industry is dependent upon the investment returns alternative asset managers can provide relative to other investment options. This factor depends, in part, on the interest rates and credit spreads (which represent the yield demanded on financial instruments by the market in comparison to a benchmark rate, such as the relevant U.S. treasury rate or LIBOR) available on other investment products because as interest rates rise and/or spreads widen, returns available on such investments would tend to increase and, therefore, become more attractive relative to the returns offered by investment products offered by alternative asset managers. We have benefited in the past years from relatively tight spreads, which have allowed us and the funds we manage to obtain financing for investments at attractive rates and made our investment products attractive relative to many other products. Although spreads over the past two years have been volatile, they have widened significantly from levels prior to the challenging market conditions. In addition to potentially reducing the relative attractiveness of our investment products, this widening will typically increase our costs when financing our investments using debt, which, in turn, reduces the net return we can earn on those investments. Furthermore, wider spreads reduce the value of investments currently owned by our funds. A reduction in the value of our funds' investments directly impacts our management fees and incentive income from such funds. As a result, this dynamic could slow capital flow to the alternative investment sector.

A second and related factor is the amount of capital invested with such managers. Over the past several years prior to 2009, institutions, high net worth individuals and other investors (including sovereign wealth funds) have increased their allocations of capital to the alternative investment sector. That said, university endowments, pension funds and other traditionally significant investors in the alternative investment sector have recently reduced the amount of capital they are investing in this sector. This decrease appears to be due to a variety of factors, including, but not limited to, the generally negative investment performance in the sector during 2008 as well as their own liquidity constraints resulting from the negative performance of their investment portfolios and near-term capital requirements. The improved performance in 2009 and early 2010 relative to 2008 appears to have modestly improved the trend of capital invested in the alternative asset investment sector. The amount of capital being invested into the alternative investment sector appears to have stabilized or even slightly increased and redemption requests appear to have decreased relative to the conditions experienced during 2008, but they are still weaker than the conditions experienced prior to the onset of the global credit and liquidity crisis that began in 2007. Rather than focusing on reducing the amount invested in the alternative investment sector, investors in alternative investment vehicles that primarily invest in liquid investments appear to have become increasingly focused on the liquidity and redemption terms of alternative investment funds and have expressed a desire to have the ability to redeem or otherwise liquidate their investments in a more rapid timeframe than what is permitted under the terms of many funds created prior to the onset of the crisis.

The third factor, which most directly impacts our results, is our investment performance relative to our competitors, including products offered by other alternative asset managers. As a historical leader in the alternative asset management sector based on the size, diversity and historical performance of our funds, we have been able to attract a significant amount of new capital both at the public company and within our funds, even during the recent challenging market conditions. For example, in April 2009, the public company successfully raised approximately \$220 million in net proceeds from an offering of its Class A shares. Moreover, during 2009 and early 2010, we have been able to raise additional capital in various funds.

*Market Considerations Summary*

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

While short-term disruptions in the markets, with respect to equity prices, interest rates, credit spreads or other market factors, including market liquidity, may adversely affect our existing positions, we believe such disruptions generally

**Table of Contents**

present significant new opportunities for investment, particularly in distressed asset classes. Our ability to take advantage of these opportunities will depend on our ability to access debt and equity capital, both at Fortress and within the funds. No assurance can be given that future trends will not be disadvantageous to us, particularly if current challenging conditions persist or intensify, or if generally improving conditions in our market reverse.

We do not currently know the full extent to which this continued uncertainty will affect us or the markets in which we operate. If the challenging conditions continue, or result in a permanent, fundamental change in the credit markets, we and the funds we manage may experience further tightening of liquidity, reduced earnings and cash flow, impairment charges, increased margin requirements, as well as challenges in maintaining our reputation, raising additional capital, maintaining compliance with debt covenants and obtaining investment financing and making investments on attractive terms. However, to date we have been able to continue raising capital, both through new and existing funds, which helps to increase our AUM and to give us a significant amount of capital available to be invested at a time when we believe attractive returns are available.

**Results of Operations**

The following is a discussion of our results of operations as reported under GAAP. For a detailed discussion of distributable earnings and revenues from each of our segments, see [Segment Analysis](#) below.

	Six Months Ended June 30,			Three Months Ended June 30,		
	2010	2009	Variance	2010	2009	Variance
<b>Revenues</b>						
Management fees from affiliates	\$ 219,430	\$ 214,077	\$ 5,353	\$ 112,894	\$ 108,425	\$ 4,469
Incentive income from affiliates	46,405	6,958	39,447	28,849	6,958	21,891
Expense reimbursements from affiliates	63,861	33,708	30,153	40,794	20,661	20,133
Other revenues	21,822	6,640	15,182	8,793	3,043	5,750
	351,518	261,383	90,135	191,330	139,087	52,243
<b>Expenses</b>						
Interest expense	7,494	15,791	(8,297)	3,698	7,605	(3,907)
Compensation and benefits	338,922	222,692	116,230	159,529	113,456	46,073
Principals agreement compensation	472,126	472,126		237,367	237,367	
General, administrative and other expense (including depreciation and amortization)	51,326	43,621	7,705	27,536	23,795	3,741
	869,868	754,230	115,638	428,130	382,223	45,907
<b>Other Income (Loss)</b>						
Gains (losses) from investments	(12,385)	16,968	(29,353)	(12,957)	19,441	(32,398)
Tax receivable agreement liability adjustment	1,317	(55)	1,372			
Earnings (losses) from equity method investees	26,031	16,208	9,823	6,150	51,057	(44,907)
	14,963	33,121	(18,158)	(6,807)	70,498	(77,305)
<b>Income (Loss) Before Income Taxes</b>	(503,387)	(459,726)	(43,661)	(243,607)	(172,638)	(70,969)
Income tax benefit (expense)	(9,186)	1,715	(10,901)	(7,634)	1,308	(8,942)
<b>Net Income (Loss)</b>	\$ (512,573)	\$ (458,011)	\$ (54,562)	\$ (251,241)	\$ (171,330)	\$ (79,911)

*Factors Affecting Our Business*

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

During the periods discussed herein, the following are significant factors which have affected our business and materially impacted our results of operations:

changes in our AUM;

level of performance of our funds; and

changes in the size of our fund management and investment platform and our related compensation structure.

### Fee Paying Assets Under Management

We measure AUM by reference to the fee paying assets we manage, including the capital we have the right to call from our investors due to their capital commitments. Our AUM has changed as a result of raising new funds, capital acquisitions, and increases in the NAVs of certain funds from new investor capital and retained profits, offset by lower performance in certain funds coupled with redemptions in our hedge funds.



**Table of Contents**

Our AUM has changed for the six months ended June 30, 2010 as follows (in millions):

2010	Private Equity		Liquid Hedge Funds	Credit		Logan Circle Partners, L.P.	Total
	Funds	Castles		Hedge Funds	PE Funds (I)		
AUM December 31, 2009	\$ 11,344	\$ 3,232	\$ 4,297	\$ 9,256	\$ 3,347	\$	\$ 31,476
Capital raised (A)			951	130	309		1,390
Equity raised		2					2
Increase in invested capital	5		3	3	682		693
Capital acquisitions						11,448	11,448
Redemptions (B)			(549)	(57)			(606)
SPV distributions (C)			(574)				(574)
RCA distributions (D)				(743)			(743)
Return of capital distributions (E)	(162)			(3)	(1,472)		(1,637)
Adjustment for reset date (F)							
Crystallized incentive income (G)			(4)				(4)
Equity buybacks		(62)					(62)
Net client flows						(150)	(150)
Income (loss) and foreign exchange (H)	324	(301)	43	158	30	173	427
AUM June 30, 2010	\$ 11,511	\$ 2,871	\$ 4,167	\$ 8,744	\$ 2,896	\$ 11,471	\$ 41,660

(A) Includes offerings of shares by the Castles, if any.

(B) Excludes redemptions which reduced AUM subsequent to June 30, 2010.

(C) Represents distributions from the Drawbridge Global Macro Fund SPV, which was established to hold the illiquid assets pertaining to investors who gave redemption notices in the fourth quarter of 2008.

(D) Represents distributions from (i) assets held within redeeming capital accounts (or RCA) in our Drawbridge Special Opportunities Funds, which represent accounts where investors have provided withdrawal notices and are subject to payout as underlying fund investments are realized, and (ii) the Value Recovery Funds.

(E) Return of capital distributions are based on realization events for private equity and credit PE funds. Such distributions include, in the case of private equity and credit PE funds that are in their capital commitment periods, recallable capital distributions.

(F) The reset date is the date on which a private equity fund or credit PE fund stops paying management fees based on commitments and starts paying such fees based on invested capital, which therefore changes fee paying AUM.

(G) Represents the transfer of value from investors (fee paying) to Fortress (non-fee paying) related to realized hedge fund incentive income.

(H) Represents the change in fee-paying NAV resulting from realized and unrealized changes in the reported value of the fund.

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

(I) As of June 30, 2010, the credit PE funds had approximately \$3.4 billion of uncalled capital that will become assets under management when deployed/called.

### *Average Fee Paying AUM*

Average fee paying AUM represents the reference amounts upon which our management fees are based. The reference amounts for management fee purposes are: (i) capital commitments or invested capital (or NAV, on an investment by investment basis, if lower) for the private equity funds and credit PE funds, which in connection with private equity funds raised after March 2006 includes the mark-to-market value on public securities held within the fund, (ii) contributed capital for the Castles, or (iii) the NAV for hedge funds and managed accounts (including Logan Circle).

### *Management Fees*

Changes in average AUM have an effect on our management fee revenues. Depending on the timing of capital contributions in a given period, the full economic benefits of an increase in AUM may not be recognized until the following period.

**Table of Contents****Performance of Our Funds**

The performance of our funds has been as follows (dollars in millions):

Name of Fund	Inception Date	Maturity Date (A)	AUM June 30,		Returns (B)		
			2010	2009	Inception to June 30, 2010		
<b>Private Equity</b>							
<i>Private Equity Funds that Report IRR s</i>							
Fund I	Nov-99	(A)	\$	\$ 36	25.8%		
Fund II	Jul-02	Feb-13	200	328	36.0%		
Fund III	Sep-04	Jan-15	1,308	1,015	(0.9)%		
Fund III Coinvestment	Nov-04	Jan-15	116	119	(1.6)%		
Fund IV	Mar-06	Jan-17	2,351	1,932	(8.5)%		
Fund IV Coinvestment	Apr-06	Jan-17	543	442	(9.6)%		
Fund V	May-07	Feb-18	3,964	3,961	(C)		
Fund V Coinvestment	Jul-07	Feb-18	935	935	(C)		
GAGACQ Coinvestment Fund	Sep-04	Permanent		9	19.2%		
FRID	Mar-05	Apr-15	403	449	(13.1)%		
FRIC	Mar-06	May-16	90	59	(18.3)%		
FICO	Aug-06	Jan-17	47	59	(75.1)%		
FHIF	Dec-06	Jan-17	912	638	(2.7)%		
FECI	Jun-07	Feb-18	532	532	(9.0)%		
<b>Returns (B)</b>							
<b>Six Months Ended</b>							
<b>June 30,</b>							
<b>Inception to Date (D)</b>							
<b>2010 2009</b>							
<i>Private Equity Funds that Report Annual Returns</i>							
Mortgage Opportunities Fund III	Jun-08	Jun-13	110	88	(12.9)%	4.5%	(C)
<i>Private Equity - Castles</i>							
Newcastle Investment Corp.	Jun-98	Permanent	1,102	1,165	N/A	N/A	N/A
Eurocastle Investment Limited	Oct-03	Permanent	1,769	2,028	N/A	(2.9)%	(7.5)%
<b>Liquid Hedge Funds</b>							
Drawbridge Global Macro Funds	Jul-02	Non-redeemable	657	2,484	9.7%	2.1%	11.3%
Fortress Macro Funds	May-09	Redeemable	2,166	1,174	10.5%	2.3%	3.2%
Fortress Commodities Fund LP	Jan-08	Redeemable	905	913	5.0%	(1.4)%	1.3%
Fortress Commodities Fund MA1 Ltd	Nov-09	Redeemable	99		(1.8)%	(1.1)%	N/A
<b>Credit Hedge Funds</b>							
Drawbridge Special Opportunities Fund LP (E)	Aug-02	PE style redemption	4,446	4,542	9.4%	11.2%	10.7%
Drawbridge Special Opportunities Fund LTD (E)	Aug-02	PE style redemption	570	476	9.1%	10.7%	9.7%
Worden Fund	Jan-10	PE style redemption	87		(C)	(C)	N/A
Fortress Partners Fund LP	Jul-06	Redeemable	806	778	(0.5)%	2.6%	6.4%
Fortress Partners Offshore Fund LP	Nov-06	Redeemable	733	658	0.2%	3.1%	7.8%
Value Recovery Funds and related assets	(F)	Non-redeemable	2,029	3,140	(F)	(F)	(F)

Continued on next page



**Table of Contents**

Name of Fund	Inception Date	Maturity Date (A)	AUM		Returns (B) Inception to June 30, 2010
			June 30, 2010	2009	
<b>Credit PE Funds</b>					
Credit Opportunities Fund	Jan-08	Oct-20	732	1,429	31.7%
Credit Opportunities Fund II	Jul-09	Jul-22	312		(C)
FTS SIP LP	Sep-08	Oct-18	143	447	36.0%
FCO MA LSS	May-10	Jun-24	25		(C)
FCO MA II	Jun-10	Jun-22	19		(C)
Long Dated Value Fund I	Apr-05	Apr-30	201	201	2.3%
Long Dated Value Fund II	Nov-05	Nov-30	204	207	2.7%
Long Dated Value Fund III	Feb-07	Feb-32	244	115	10.4%
LDVF Patent Fund	Nov-07	Nov-27	12	14	19.5%
Real Assets Fund	Jun-07	Jun-17	132	126	8.7%
Assets Overflow Fund	Jul-08	May-18	34	81	(C)
Japan Opportunity Fund	Jun-09	Jun-19	833	137	(C)
Net Lease Fund I	Jan-10	Jan-23	5		(C)
Subtotal - all funds			29,776	30,717	
Managed accounts			413	79	
Total - Alternative Investment			30,189	30,796	
Logan Circle Partners, L.P.			11,471		
Total (G)			\$ 41,660	\$ 30,796	

(A) For funds with a contractual maturity date, maturity date represents the final contractual maturity date including the assumed exercise of extension options, which in some cases require the approval of the applicable fund advisory board. Fund I has passed its contractual maturity date and is in the process of an orderly wind down. The Castles are considered to have permanent equity as they have an indefinite life and no redemption terms. The liquid hedge funds and the Fortress Partners funds are generally redeemable at the option of the fund investors. The Drawbridge Special Opportunity Funds and Worden Fund may pay redemptions over time, as the underlying investments are realized, in accordance with their governing documents ( PE style redemption ). The Drawbridge Global Macro Funds and Value Recovery Funds generally do not allow for redemptions, but are in the process of realizing their remaining investments in an orderly liquidation. Management notes that funds which had a term of three years or longer at inception, funds which have permanent equity, funds which have a PE style redemption and funds which do not allow for redemptions aggregated approximately 81% of our alternative investment AUM as of June 30, 2010.

(B) Represents the following:

For private equity funds, other than the Mortgage Opportunities Funds, and credit PE funds, returns represent net annualized internal rates of return to limited partners after management fees and incentive allocations, and are computed on an inception to date basis consistent with industry standards. Incentive allocations are computed based on a hypothetical liquidation of net assets of each fund as of the balance sheet date. Returns are calculated for the investors as a whole. The computation of such returns for an individual investor may vary from these returns based on different management fee and incentive arrangements, and the timing of capital transactions.

For Castles, returns represent the return on invested equity (ROE). ROE is not reported on an inception to date basis. Newcastle's 2009 and 2010 ROE is not meaningful because Newcastle had negative book equity.

For liquid and credit hedge funds, as well as the Mortgage Opportunities Fund, returns represent net returns after taking into account any fees borne by the funds for a new issue eligible, single investor class as of the close of business on the last date of the relevant period. Specific performance may vary based on, among other things, whether fund investors are invested in one or more special investments.

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

- (C) These funds: (a) were in their investment periods, or (b) had less than one year elapsed from their inception, and had no successor fund formed, through the end of these years. In some cases, particularly Fund V and Fund V Coinvestment, returns during these periods were significantly negative.
- (D) For liquid hedge funds, credit hedge funds and Mortgage Opportunities Funds, reflects a composite of monthly returns presented on an annualized net return basis.
- (E) The returns for the Drawbridge Special Opportunities Funds reflect the performance of each fund excluding the performance of the redeeming capital accounts (i.e. investors who requested redemptions in prior periods and who are being paid out as investments are realized).
- (F) Fortress began managing the third party originated Value Recovery Funds in June 2009. Their returns are not comparable since we are only managing the realization of existing investments within these funds which were acquired prior to Fortress becoming their manager.
- (G) In addition to the funds listed, Fortress manages the GAGACQ Fund, NIH, FBIF, FPRF and Mortgage Opportunities Funds I and II. Such funds are excluded from the table because they did not include any fee paying assets under management at the end of the periods presented.

**Table of Contents***Incentive Income*

Incentive income is calculated as a percentage of profits (or in some cases taxable income) earned by the Fortress Funds. Incentive income that is not subject to contingent repayment is recorded as earned. Incentive income received from funds that continues to be subject to contingent repayment is deferred and recorded as a deferred incentive income liability until the related contingency is resolved. The contingencies related to a portion of the incentive income we have received from certain private equity Fortress Funds have been resolved.

**Fund Management and Investment Platform**

In order to accommodate the demands of our funds' investment portfolios, we have created investment platforms, which are comprised primarily of our people, financial and operating systems and supporting infrastructure. Expansion of our investment platform historically required increases in headcount, consisting of newly hired investment professionals and support staff, as well as leases and associated improvements to corporate offices to house the increasing number of employees, and related augmentation of systems and infrastructure. Our ending headcount was 826 at June 30, 2009 and 880 at June 30, 2010.

**Revenues**

	Six Months Ended June 30,			Three Months Ended June 30,		
	2010	2009	Variance	2010	2009	Variance
Management fees from affiliates	\$ 219,430	\$ 214,077	\$ 5,353	\$ 112,894	\$ 108,425	\$ 4,469
Incentive income from affiliates	46,405	6,958	39,447	28,849	6,958	21,891
Expense reimbursements from affiliates	63,861	33,708	30,153	40,794	20,661	20,133
Other revenues	21,822	6,640	15,182	8,793	3,043	5,750
<b>Total Revenues</b>	<b>\$ 351,518</b>	<b>\$ 261,383</b>	<b>\$ 90,135</b>	<b>\$ 191,330</b>	<b>\$ 139,087</b>	<b>\$ 52,243</b>

*Six months ended June 30*

For the six months ended June 30, 2010 compared with the six months ended June 30, 2009, total revenues increased as a result of the following:

Management fees from affiliates increased by \$5.4 million primarily due to (i) the recognition of \$6.0 million in accrued management fees previously deemed uncollectible, (ii) a \$0.9 million net increase in management fees generated by the net increase to average AUM, partially offset by (iii) a decrease of \$1.3 million as a result of a decrease in the average management fee percentage earned, and (iv) a \$0.3 million decrease in management fees as a result of changes in foreign currency exchange rates. The \$0.9 million net increase in management fees generated by the net change to average AUM was primarily due to the net effect of increases (decreases) in average AUM of (\$1.2) billion, (\$0.7) billion, \$1.3 billion and \$0.9 billion in our private equity funds, our liquid hedge funds, our credit hedge funds, and our credit PE funds, respectively.

Incentive income from affiliates increased by \$39.4 million primarily as a result of (i) \$19.3 million in incentive income recognized from our credit PE funds generated from distributions not subject to clawback for the six months ended June 30, 2010 as compared to \$6.8 million of incentive income recognized for the prior comparative period and (ii) \$27.4 million of incentive income recognized from our private equity funds for the six months ended June 30, 2010 as compared to no incentive income recognized for the prior comparative period. The \$27.4 million in incentive income recognized from our private equity funds for the six months ended June 30, 2010 primarily related to the recognition of \$1.6 million and \$25.8 million in incentive income from Fund I and Fund II, respectively, as contingencies for repayment had been resolved allowing for income recognition.

Expense reimbursements from affiliates, which are recorded gross on our statement of operations, increased by \$30.2 million primarily as a result of (i) \$15.2 million of expense reimbursements recognized due to the consolidation of FCF, the operating subsidiary of one of our private equity funds, effective March 2010 and (ii) an increase of \$14.9 million in operating expenses eligible for reimbursement from our funds for the six months ended June 30, 2010 as compared to the prior comparative period. The \$14.9 million increase in operating expenses eligible for reimbursement from our funds was primarily attributable to the Value Recovery Funds, which Fortress began managing in June 2009, and an increase in accrued compensation expense for the six months ended June 30, 2010.

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Other revenues increased by \$15.2 million primarily due to (i) an increase of \$4.4 million in incentive income earned from non-affiliates, (ii) an increase of \$3.7 million in management fees from Logan Circle which we acquired in April 2010, (iii)



**Table of Contents**

an increase of \$3.4 million in management fees from non-affiliates primarily attributed to a net increase of \$0.3 billion in average AUM from our managed accounts excluding Logan Circle for the six months ended June 30, 2010 as compared to the prior comparative period, and (iv) an increase of \$3.1 million in dividend income earned from our direct investments, of which \$0.4 million in dividend income was earned on a direct investment that has been liquidated.

*Three months ended June 30*

For the three months ended June 30, 2010 compared with the three months ended June 30, 2009, total revenues increased as a result of the following:

Management fees from affiliates increased by \$4.5 million primarily due to (i) the recognition of \$6.0 million in accrued management fees previously deemed uncollectible, partially offset by (ii) a decrease of \$0.5 million as a result of a decrease in the average management fee percentage earned, (iii) a \$0.7 million decrease in management fees as a result of changes in foreign currency exchange rates, and (iv) a \$0.4 million net decrease in management fees generated by the net change to average AUM. The \$0.4 million net decrease in management fees generated by the net change to average AUM was primarily due to the net effect of increases (decreases) in average AUM of (\$1.2) billion, (\$0.2) billion, (\$0.5) billion, \$1.2 billion and \$0.8 billion in our private equity funds, our Castles, our liquid hedge funds, our credit hedge funds, and our credit PE funds, respectively. Although average AUM increased overall, due to differences in the average management percent earned between segments and other factors, these changes in AUM resulted in a slight overall decrease in management fees.

Incentive income from affiliates increased by \$21.9 million primarily as a result of \$27.4 million of incentive income recognized from our private equity funds for the three months ended June 30, 2010 as compared to no incentive income recognized for the prior comparative period. This increase was partially offset by a \$5.5 million decrease in incentive income recognized from our credit PE funds generated from distributions not subject to clawback of \$1.3 million for the three months ended June 30, 2010 as compared to \$6.8 million for the three months ended June 30, 2009. The \$27.4 million in incentive income recognized from our private equity funds for the three months ended June 30, 2010 primarily related to the recognition of \$1.6 million and \$25.8 million in incentive income from Fund I and Fund II, respectively, as contingencies for repayment had been resolved allowing for income recognition.

Expense reimbursements from affiliates increased by \$20.1 million primarily as a result of (i) \$15.2 million of expense reimbursements recognized due to the consolidation of FCF effective March 2010 and (ii) an increase of \$5.0 million in operating expenses eligible for reimbursement from our funds for the three months ended June 30, 2010, primarily attributable to the Value Recovery Funds, which Fortress began managing in June 2009, and an increase in accrued compensation expense, as compared to the three months ended June 30, 2009.

Other revenues increased by \$5.8 million primarily due to (i) an increase of \$3.7 million in management fees from Logan Circle which we acquired in April 2010 and (ii) a net increase of \$1.7 million in management fees from non-affiliates primarily attributed to a net increase of \$0.3 billion in average AUM from our managed accounts excluding Logan Circle.

**Expenses**

	Six Months Ended June 30,			Three Months Ended June 30,		
	2010	2009	Variance	2010	2009	Variance
Interest expense	\$ 7,494	\$ 15,791	\$ (8,297)	\$ 3,698	\$ 7,605	\$ (3,907)
Compensation and benefits	338,922	222,692	116,230	159,529	113,456	46,073
Principals agreement compensation	472,126	472,126		237,367	237,367	
General, administrative and other (including depreciation and amortization)	51,326	43,621	7,705	27,536	23,795	3,741
<b>Total Expenses</b>	<b>\$ 869,868</b>	<b>\$ 754,230</b>	<b>\$ 115,638</b>	<b>\$ 428,130</b>	<b>\$ 382,223</b>	<b>\$ 45,907</b>

*Six months ended June 30*

For the six months ended June 30, 2010 compared with the six months ended June 30, 2009, total expenses increased as a result of the following:

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Interest expense decreased by \$8.3 million primarily due to (i) a decrease of \$3.5 million due to write-offs of deferred financing costs that were recognized during the six months ended June 30, 2009, (ii) a decrease of \$3.2 million due to a decrease in average borrowings as compared to the six months ended June 30, 2009, and (iii) a decrease of \$1.7 million in the amortization of deferred financing costs.

## **Table of Contents**

Compensation and benefits increased by \$116.2 million primarily due to (i) a \$67.6 million net increase in profit sharing compensation primarily as a result of an increase in incentive income distributions from our credit PE funds, (ii) an increase of \$20.7 million in compensation and benefits due to the consolidation of FCF effective March 2010, the acquisition of Logan Circle in April 2010, and the Value Recovery Funds which Fortress began managing in June 2009, (iii) an increase of \$21.6 million due to an increase in discretionary bonuses excluding the impact of FCF, Logan Circle, and the Value Recovery Funds for the six months ended June 30, 2010, and (iv) a net increase of \$7.2 million in equity-based compensation primarily due to an increase in amortization expense resulting from new RSU awards granted for the six months ended June 30, 2010.

Principals agreement compensation is being amortized on a straight-line basis over the term of the agreement.

General, administrative and other expenses increased by \$7.7 million primarily as a result of (i) additional expenses of \$5.5 million related to the consolidation of FCF and acquisition of Logan Circle in April 2010, (ii) a net increase of \$7.3 million in recruiting, hardware and software maintenance and other general expenses, and (iii) an increase in depreciation and amortization expense of \$0.6 million, offset by (iv) a net reversal of the allowance for potentially uncollectible management fees in the amount of \$2.8 million primarily in connection with the resolution of liquidity shortfalls within a certain fund and (v) a decrease in professional fees and consulting fees of \$3.2 million.

### *Three months ended June 30*

For the three months ended June 30, 2010 compared with the three months ended June 30, 2009, total expenses increased as a result of the following:

Interest expense decreased by \$3.9 million primarily due to (i) a decrease of \$1.6 million due to write-offs of deferred financing costs that were recognized during the three months ended June 30, 2009, (ii) a decrease of \$1.4 million due to a decrease in average borrowings as compared to the three months ended June 30, 2009, and (iii) a decrease of \$1.1 million in the amortization of deferred financing costs.

Compensation and benefits increased by \$46.1 million primarily due to (i) a \$20.8 million net increase in profit sharing compensation primarily as a result of an increase in incentive income distributions from our credit PE funds, (ii) an increase of \$17.2 million in compensation and benefits due to the consolidation of FCF effective March 2010, the acquisition of Logan Circle in April 2010, and the Value Recovery Funds which Fortress began managing in June 2009, (iii) an increase of \$12.1 million due to an increase in discretionary bonuses excluding the impact of FCF, Logan Circle, and the Value Recovery Funds for the three months ended June 30, 2010, and offset by (iv) a net decrease of \$3.6 million in equity-based compensation due to the impact of an increase in the forfeiture assumption associated with RSU awards, offset by an increase in amortization expense resulting from new RSU awards granted for the six months ended June 30, 2010.

Principals agreement compensation is being amortized on a straight-line basis over the term of the agreement.

General, administrative and other expenses increased by \$3.7 million primarily as a result of (i) additional expenses of \$5.5 million related to the consolidation of FCF and acquisition of Logan Circle in April 2010, (ii) a net increase of \$4.1 million in recruiting, hardware and software maintenance and other general expenses, and (iii) an increase in depreciation and amortization expense of \$0.5 million, offset by (iv) a reversal of the allowance for potentially uncollectible management fees in the amount of \$3.8 million primarily in connection with the resolution of liquidity shortfalls within a certain fund and (v) a decrease in professional fees and consulting fees of \$2.8 million.

### *Future Compensation Expense*

In future periods, we will further recognize non-cash compensation expense on our non-vested equity-based awards of \$549 million with a weighted average recognition period of 2.7 years. This does not include contingent amounts or amounts related to the Principals Agreement, which is discussed above.

### *Principals Agreement Compensation*

As a result of the Principals Agreement, \$4,763.0 million is being charged to compensation expense on a straight-line basis over the five-year vesting period. Fortress is not a party to this agreement. It is an agreement between the Principals to further incentivize them to remain with Fortress. This GAAP expense has no economic effect on Fortress or its shareholders. When Fortress records this non-cash expense, it records a corresponding increase in capital.



**Table of Contents**

GAAP Net Income (Loss) Excluding Principals Agreement Compensation is calculated as follows:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2010	2009	2010	2009
GAAP Net Income (Loss)	\$ (512,573)	\$ (458,011)	\$ (251,241)	\$ (171,330)
Principals Agreement Compensation	472,126	472,126	237,367	237,367
<b>GAAP Net Income (Loss) Excluding Principals Agreement Compensation</b>	<b>\$ (40,447)</b>	<b>\$ 14,115</b>	<b>\$ (13,874)</b>	<b>\$ 66,037</b>

**Other Income (Loss)**

	Six Months Ended June 30,			Three Months Ended June 30,		
	2010	2009	Variance	2010	2009	Variance
Gains (losses) from investments	\$ (12,385)	\$ 16,968	\$ (29,353)	\$ (12,957)	\$ 19,441	\$ (32,398)
Tax receivable agreement liability adjustment	1,317	(55)	1,372			
Earnings (losses) from equity method investees	26,031	16,208	9,823	6,150	51,057	(44,907)
<b>Total Other Income (Loss)</b>	<b>\$ 14,963</b>	<b>\$ 33,121</b>	<b>\$ (18,158)</b>	<b>\$ (6,807)</b>	<b>\$ 70,498</b>	<b>\$ (77,305)</b>

*Six months ended June 30*

For the six months ended June 30, 2010 compared with the six months ended June 30, 2009, total other income (loss) decreased as a result of the following:

Gains (losses) from investments decreased by \$29.4 million primarily due to (i) the recognition of a net unrealized loss of \$11.0 million on our investments in GAGFAH and our Castles for the six months ended June 30, 2010, as compared to the recognition of a net unrealized gain of \$17.7 million on our investments in GAGFAH and our Castles for the six months ended June 30, 2009, and (ii) the recognition of a net unrealized loss of \$0.6 million on our foreign currency hedges for the six months ended June 30, 2010.

Earnings (losses) from equity method investees increased by \$9.8 million primarily due to the net effect of (i) the recognition of \$26.0 million in net income from equity method investees in 2010 as a result of an increase in income attributable to investments in our private equity funds, liquid hedge funds, credit hedge funds and credit PE funds, compared to (ii) the recognition of a \$16.2 million in net income on our equity method investments for the six months June 30, 2009. The overall increase in income was primarily a result of improved returns within our private equity funds.

*Three months ended June 30*

For the three months ended June 30, 2010 compared with the three months ended June 30, 2009, total other income (loss) decreased as a result of the following:

Gains (losses) from investments decreased by \$32.4 million primarily due to (i) the recognition of a net unrealized loss of \$11.0 million for the three months ended June 30, 2010 on our investments in GAGFAH and in our Castles, as compared to the recognition of a net unrealized gain of \$19.5 million on our investments in GAGFAH and in our Castles for the three months ended June 30, 2009, (ii) a \$0.8 million net decrease in realized gains related to changes in the foreign currency exchange rates from the three months ended June 30, 2009 to the three months ended June 30, 2010, (iii) the recognition of a net unrealized loss of \$0.6 million on our foreign currency hedges during the three months ended June 30, 2010, and (iv) a net decrease in unrealized gains of \$0.5 million for the three months ended June 30, 2010 on our options in our Castles.

Earnings (losses) from equity method investees decreased by \$44.9 million primarily due to the net effect of (i) the recognition of \$6.2 million in net income from equity method investees in 2010 as a result of a decrease in income attributable to investments in our private equity funds, liquid hedge funds, credit hedge funds and credit PE funds, compared to (ii) the recognition of \$51.1 million in net income on our equity method

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

investments for the three months June 30, 2009. The overall decrease was primarily a result of diminished returns within the funds.

### Income Tax Benefit (Expense)

Fortress has recorded a significant deferred tax asset. A substantial portion of this asset is offset by a liability associated with the tax receivable agreement with our Principals. This deferred tax asset is further discussed under [Critical Accounting Policies](#) below and the tax receivable agreement is discussed in our consolidated financial statements included herein.

**Table of Contents**

For the six and three months ended June 30, 2010, Fortress recognized income tax expense (benefit) of \$9.2 million and \$7.6 million, respectively. For the six and three months ended June 30, 2009, Fortress recognized income tax expense (benefit) of (\$1.7 million) and (\$1.3 million), respectively. The primary reasons for the changes in income tax expense (benefit) for the six and three months ended June 30, 2010 compared to the six and three months ended June 30, 2009 are (i) changes in the mix of business segments producing income, which may be subject to tax at different rates, (ii) changes in the forecasts of annual taxable income which are used to calculate the tax provision, and (iii) a write off of a portion of the deferred tax asset related to RSUs which vested and were delivered at a value substantially less than their original value.

**Segment Analysis**

Fortress conducts its management and investment business through the following primary segments: (i) private equity funds, (ii) Castles, (iii) liquid hedge funds, (iv) credit hedge funds, (v) credit PE funds, and (vi) principal investments in these funds as well as cash that is available to be invested. These segments are differentiated based on their varying strategies.

Discussed below are our results of operations for each of our reportable segments. They represent the separate segment information available and utilized by our management committee, which consists of our principals and certain key officers, and which functions as our chief operating decision maker to assess performance and to allocate resources. Management evaluates the performance of each segment based on its distributable earnings.

Management assesses our segments on a Fortress Operating Group and pre-tax basis, and therefore adds back the non-controlling interests in consolidated subsidiaries related to Fortress Operating Group units (held by the principals) and income tax expense.

Distributable earnings is defined in Note 10 to Part I, Item 1, Financial Statements and Supplementary Data Segment Reporting. Furthermore, a complete discussion of distributable earnings basis impairment and reserves, including the methodology used in estimating the amounts as well as the amounts incurred in the relevant periods, is disclosed therein.

**Private Equity Funds**

	Six Months Ended June 30,			Three Months Ended June 30,		
	2010	2009	Variance	2010	2009	Variance
Management Fees	\$ 66,545	\$ 76,515	\$ (9,970)	\$ 33,293	\$ 38,884	\$ (5,591)
Incentive Income						
Segment revenues - total	\$ 66,545	\$ 76,515	\$ (9,970)	\$ 33,293	\$ 38,884	\$ (5,591)
Pre-tax distributable earnings	\$ 49,431	\$ 56,856	\$ (7,425)	\$ 24,869	\$ 27,567	\$ (2,698)

*Six months ended June 30*

Pre-tax distributable earnings decreased by \$7.4 million primarily due to:

a \$10.0 million net decrease in management fees. Management fees decreased by \$10.0 million primarily as a result of the net asset value of certain portfolio companies in our private equity funds and special investments declining below their invested capital (in particular, within FICO, Fund IV, Fund IV Coinvestment, FRID and FHIF); and

a \$2.5 million decrease in operating expenses primarily related to (i) a \$0.6 million decrease in compensation and benefits expense, and (ii) a decrease of \$1.8 million in professional fees and other general expenses, which was primarily attributed to write-offs that were recognized in the prior comparative period for capitalized professional fees and other general expenses for a fund which did not launch.

*Three months ended June 30*

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Pre-tax distributable earnings decreased by \$2.7 million primarily due to:

a \$5.6 million net decrease in management fees. Management fees decreased by \$5.6 million primarily as a result of the net asset value of certain portfolio companies in our private equity funds and special investments declining below their invested capital (in particular, within FICO, Fund IV, Fund IV Coinvestment, FRID and FHIF); and

a \$2.9 million decrease in operating expenses primarily related to (i) a \$1.1 million decrease in compensation and benefits expense, and (ii) a decrease of \$1.6 million in professional fees and other general expenses, which was primarily attributed to write-offs that were recognized in the prior comparative period for capitalized professional fees and other general expenses for a fund which did not launch.



**Table of Contents**Publicly Traded Alternative Investment Vehicles ( Castles )

	Six Months Ended June 30,			Three Months Ended June 30,		
	2010	2009	Variance	2010	2009	Variance
Management Fees	\$ 23,978	\$ 24,430	\$ (452)	\$ 11,439	\$ 12,519	\$ (1,080)
Incentive Income						
Segment revenues - total	\$ 23,978	\$ 24,430	\$ (452)	\$ 11,439	\$ 12,519	\$ (1,080)
Pre-tax distributable earnings	\$ 9,157	\$ 10,714	\$ (1,557)	\$ 4,720	\$ 6,725	\$ (2,005)

*Six months ended June 30*

Pre-tax distributable earnings decreased by \$1.6 million primarily due to:

a \$0.5 million decrease in management fees primarily due to a \$0.3 million decrease as a result of changes in foreign currency exchange rates and a \$0.2 million net decrease as a result of a decrease in AUM; and

a \$1.0 million net increase in operating expenses primarily as a result of a \$0.4 million increase in allocable corporate expenses and a \$0.5 million increase in general and administrative expenses.

*Three months ended June 30*

Pre-tax distributable earnings decreased by \$2.0 million primarily due to:

a \$1.1 million decrease in management fees primarily due to a \$0.7 million decrease as a result of changes in foreign currency exchange rates, a \$0.2 million decrease in management fees from non-affiliates, and a \$0.2 million decrease as a result of a decrease in average AUM; and

a \$0.9 million net increase in operating expenses primarily as a result of a \$0.6 million increase in compensation expense and a \$0.6 million increase in general and administrative expenses partially offset by a decrease of \$0.3 million in allocable corporate expenses.

Liquid Hedge Funds

	Six Months Ended June 30,			Three Months Ended June 30,		
	2010	2009	Variance	2010	2009	Variance
Management Fees	\$ 38,285	\$ 42,522	\$ (4,237)	\$ 19,483	\$ 19,893	\$ (410)
Incentive Income	4,247	247	4,000	(1,255)	247	(1,502)
Segment revenues - total	\$ 42,532	\$ 42,769	\$ (237)	\$ 18,228	\$ 20,140	\$ (1,912)
Pre-tax distributable earnings	\$ 8,813	\$ 12,706	\$ (3,893)	\$ 1,001	\$ 6,731	\$ (5,730)

*Six months ended June 30*

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Pre-tax distributable earnings decreased by \$3.9 million primarily due to:

a \$3.1 million net decrease in management fees. Management fees decreased by \$4.2 million primarily due to declines in average AUM caused by investor redemptions subsequent to June 30, 2009 which resulted in decreases of \$23.0 million and \$1.1 million from the Drawbridge Global Macro Funds and the Fortress Commodities Fund, respectively. These decreases were offset by (i) a \$16.0 million increase due to management fees generated from the Fortress Macro Funds which were launched in May 2009 and (ii) a \$3.9 million increase due to management fees generated from certain managed accounts which launched in November 2009 and January 2010. The \$4.2 million management fee decrease was partially offset by a corresponding decrease in the employees' share of management fees of \$1.1 million;

a \$4.5 million net increase in incentive income primarily due to (i) increases of \$3.6 million and \$0.4 million in the incentive income generated by the Fortress Macro Funds and Fortress Commodities Funds, respectively, for the six months ended June 30, 2010 and (ii) a \$0.5 million decrease to employees' share of incentive income as a result of a reduction of previously accrued profit sharing compensation expense; and

a \$5.3 million net increase in operating expenses primarily due to (i) a \$3.0 million increase in compensation expense primarily due to an increase in the accrual of discretionary bonuses and (ii) a \$2.2 million increase in general and administrative expenses and allocable corporate expenses for the six months ended June 30, 2010 as compared to the prior comparative period.

**Table of Contents***Three months ended June 30*

Pre-tax distributable earnings decreased by \$5.7 million primarily due to:

a \$0.8 million net increase in management fees. Management fees decreased by \$0.4 million primarily due to declines in average AUM caused by investor redemptions subsequent to June 30, 2009 which resulted in decreases of \$8.9 million and \$0.1 million from the Drawbridge Global Macro Funds and the Fortress Commodities Fund, respectively. These decreases were offset by (i) a \$6.5 million increase due to management fees generated from the Fortress Macro Funds which launched in May 2009 and (ii) a \$2.1 million increase due to management fees generated from certain managed accounts which launched in November 2009 and January 2010. The \$0.4 million management fee decrease was offset by a decrease in the employees' share of management fees net of operating expenses (which increased as described below) of \$1.2 million for the three months ended June 30, 2010 as compared to the prior comparative period;

a \$0.6 million net decrease in incentive income. Incentive income decreased by \$1.5 million which was partially offset by a net decrease in the employees' share of incentive income, reflected as profit sharing compensation expense, of \$0.9 million. Incentive income decreased by \$1.5 million due to a decrease of \$1.9 million in the incentive income generated by the Fortress Macro Funds which was partially offset by an increase of \$0.4 million in incentive income generated by the Fortress Commodities Fund for the three months ended June 30, 2010; and

a \$5.9 million net increase in operating expenses primarily due to (i) a \$2.7 million increase in compensation expense primarily due to an increase in the accrual of discretionary bonuses and (ii) a \$3.2 million increase in general and administrative expenses and allocable corporate expenses for the three months ended June 30, 2010 as compared to the prior comparative period.

Credit Hedge Funds

	Six Months Ended June 30,			Three Months Ended June 30,		
	2010	2009	Variance	2010	2009	Variance
Management Fees	\$ 76,619	\$ 57,624	\$ 18,995	\$ 43,517	\$ 29,501	\$ 14,016
Incentive Income	13,520	1,013	12,507	5,199	191	5,008
Segment revenues - total	\$ 90,139	\$ 58,637	\$ 31,502	\$ 48,716	\$ 29,692	\$ 19,024
Pre-tax distributable earnings	\$ 29,625	\$ 10,371	\$ 19,254	\$ 18,863	\$ 7,467	\$ 11,396

*Six months ended June 30*

Pre-tax distributable earnings increased by \$19.3 million primarily due to:

a \$19.0 million net increase in management fees primarily as a result of (i) a \$15.7 million increase in management fees from the Value Recovery Funds and related assets, which Fortress began managing in June 2009, of which \$9.8 million relates to the recognition in the second quarter of 2010 of management fees which were previously deemed potentially uncollectible, (ii) a \$2.6 million net increase in management fees from the Drawbridge Special Opportunities Funds and Fortress Partners Funds resulting primarily from an increase in average AUM, primarily due to the net appreciation of investments and offset by investor redemptions, subsequent to June 30, 2009 and (iii) a \$0.8 million increase in management fees from the Worden Fund, which launched in January 2010;

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

a \$7.1 million net increase in incentive income. Incentive income increased by \$12.5 million and was partially offset by a corresponding increase in the employees' share of incentive income, reflected as profit sharing compensation expense, of \$5.4 million. Incentive income increased by \$12.5 million primarily due to (i) an increase of \$5.2 million due to an increase in the average capital eligible for incentive income as certain credit hedge funds met or exceeded their high water marks during the six months ended June 30, 2010, (ii) a \$4.4 million increase in incentive income from a third party account we manage, and (iii) \$2.9 million of incentive income from special investments; and

a \$7.0 million net increase in operating expenses primarily related to an increase of (i) \$5.6 million in compensation expenses primarily related to an increase in the accrual of discretionary bonuses, and (ii) a \$3.8 million net increase in general and administrative expenses and allocable corporate expenses for the six months ended June 30, 2010 as compared to the prior comparative period. These increases were partially offset by a \$2.4 million increase in expense reimbursement from the Value Recovery Funds of compensation expense for certain credit hedge fund employees that have provided services to the Value Recovery Funds.

**Table of Contents***Three months ended June 30*

Pre-tax distributable earnings increased by \$11.4 million primarily due to:

a \$14.0 million net increase in management fees primarily as a result of (i) a \$12.2 million increase in management fees from the Value Recovery Funds and related assets, which Fortress began managing in June 2009, of which \$9.8 million relates to the recognition in the second quarter of 2010 of management fees which were previously deemed potentially uncollectible, (ii) a \$1.4 million net increase in management fees from the Drawbridge Special Opportunities Funds and Fortress Partners Funds resulting primarily from an increase in average AUM, primarily due to the net appreciation of investments and offset by investor redemptions, subsequent to June 30, 2009 and (iii) a \$0.4 million increase in management fees from the Worden Fund, which launched in January 2010;

a \$2.7 million net increase in incentive income. Incentive income increased by \$5.0 million and was partially offset by a corresponding increase in the employees' share of incentive income, reflected as profit sharing compensation expense, of \$2.3 million. Incentive income increased by \$5.0 million primarily due to (i) an increase of \$4.8 million due to an increase in the average capital eligible for incentive income as certain credit hedge funds met or exceeded their high water marks during the three months ended June 30, 2010, (ii) a \$0.1 million increase in incentive income from a third party account we manage, and (iii) \$0.1 million of incentive income from special investments; and

a \$5.3 million net increase in operating expenses primarily related to an increase of (i) \$3.8 million in compensation expenses primarily related to an increase in the accrual of discretionary bonuses, and (ii) a \$2.5 million net increase in general and administrative expenses and allocable corporate expenses for the three months ended June 30, 2010 as compared to the prior comparative period. These increases were partially offset by a \$0.9 million increase in expense reimbursement from the Value Recovery Funds of compensation expense for certain credit hedge fund employees that have provided services to the Value Recovery Funds.

Credit PE Funds

	Six Months Ended June 30,			Three Months Ended June 30,		
	2010	2009	Variance	2010	2009	Variance
Management Fees	\$ 21,314	\$ 14,435	\$ 6,879	\$ 11,157	\$ 8,354	\$ 2,803
Incentive Income	131,546	6,814	124,732	46,396	6,814	39,582
Segment revenues - total	\$ 152,860	\$ 21,249	\$ 131,611	\$ 57,553	\$ 15,168	\$ 42,385
Pre-tax distributable earnings	\$ 74,790	\$ 6,823	\$ 67,967	\$ 28,989	\$ 4,590	\$ 24,399

*Six months ended June 30*

Pre-tax distributable earnings increased by \$68.0 million primarily due to:

a \$6.9 million increase in management fees primarily due to (i) \$8.8 million generated by new credit PE funds created after June 30, 2009, most notably the Japan Opportunity Fund and Credit Opportunities Fund II, and (ii) a \$0.6 million increase attributable to capital calls made after June 30, 2009 by Long Dated Value Fund III. These increases in management fees were partially offset by a net decrease of \$2.5 million primarily due to the return of capital to investors in the Credit Opportunities Fund I, the Real Assets Fund, and a third party account we manage;

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

a \$60.9 million net increase in incentive income. Incentive income increased by \$124.7 million, partially offset by an increase in the employees' share of incentive income of \$63.8 million which is reflected as profit sharing compensation expense. The \$124.7 million increase in incentive income is primarily due to distributions generated by certain realization events during the six months ended June 30, 2010 from the Credit Opportunities Fund I and a third party account we manage; and

a \$0.2 million net decrease in operating expenses primarily due to a reduction in commissions relating to the Japan Opportunity Fund as compared to the six months ended June 30, 2009 and the write-off in the second quarter of 2009 of professional fees attributable to a fund which did not launch. These decreases were partially offset by an increase in allocable corporate expenses and compensation expenses primarily as a result of increased headcount from new funds.

*Three months ended June 30*

Pre-tax distributable earnings increased by \$24.4 million primarily due to:

a \$2.8 million increase in management fees primarily due to (i) \$5.9 million generated by new credit PE funds created after June 30, 2009, most notably the Japan Opportunity Fund and Credit Opportunities Fund II, and (ii) a \$0.3 million increase attributable to capital calls made after June 30, 2009 by Long Dated Value Fund III. These increases in management fees were partially offset by a net decrease of \$3.4 million primarily due to the return of capital to investors in the Credit Opportunities Fund I, the Real Assets Fund, and a third party account we manage;

**Table of Contents**

a \$19.0 million net increase in incentive income. Incentive income increased by \$39.6 million, partially offset by an increase in the employees' share of incentive income of \$20.6 million which is reflected as profit sharing compensation expense. The \$39.6 million increase in incentive income is primarily due to distributions generated by certain realization events during the three months ended June 30, 2010 from the Credit Opportunities Fund I and a third party account we manage; and

a \$2.6 million net decrease in operating expenses primarily due to a reduction in commissions relating to the Japan Opportunity Fund as compared to the three months ended June 30, 2009 and the write-off in the second quarter of 2009 of professional fees attributable to a fund which did not launch.

**Principal Investments**

	Six Months Ended June 30,			Three Months Ended June 30,		
	2010	2009	Variance	2010	2009	Variance
Pre-tax distributable earnings (loss)	\$ 4,320	\$ (29,114)	\$ 33,434	\$ 71	\$ 5,920	\$ (5,849)

*Six months ended June 30*

Pre-tax distributable earnings (loss) increased by \$33.4 million primarily due to:

a \$27.6 million increase in net investment income primarily as a result of a decrease in impairments of \$24.9 million, \$0.2 million, \$0.6 million and \$2.0 million in our investments in our private equity funds, Castles, credit PE funds, and special investments in our hedge funds for the six months ended June 30, 2010 as compared to the six months ended June 30, 2009;

a \$2.8 million net decrease in investment income from our investments in our credit PE funds and hedge funds. Investment income decreased \$0.4 million and the employee share of investment income increased by \$2.4 million. The \$0.4 million decrease in investment income was due to lower returns on our investments in our credit hedge funds of \$9.3 million offset by an increase of \$9.0 million due to realization events in one of our credit PE funds for the six months ended June 30, 2010 as compared to the prior comparative period. The employee share of investment income increased due to an increase in the percentage of the fund owned by employees;

an \$8.3 million increase in net investment income primarily due to a decrease in interest expense primarily due to (i) a decrease of \$3.5 million due to write-offs of deferred financing costs that were recognized during the six months ended June 30, 2009, (ii) a decrease of \$3.2 million due to a decrease in average borrowings as compared to the six months ended June 30, 2009, and (iii) a decrease of \$1.7 million in the amortization of deferred financing costs;

a \$0.4 million increase in net investment income due to an increase in the average cash balance and interest rate over the six months ended June 30, 2010 as compared to the prior comparative period;

a \$0.2 million increase in net investment income due to dividend income earned primarily from our direct investments in GAGFAH common stock and an investment which has been liquidated; and

a \$0.5 million decrease in net investment income due to foreign currency translation adjustments.

*Three months ended June 30*

Pre-tax distributable earnings (loss) decreased by \$5.8 million primarily due to:

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

a \$0.3 million decrease in net investment income primarily as a result of increased impairments in special investments in our hedge funds for the three months ended June 30, 2010 as compared to the three months ended June 30, 2009;

a \$9.0 million net decrease in net investment income from our investments in our credit PE funds and hedge funds. Investment income decreased \$9.4 million and the employee share of investment income decreased by \$0.4 million. The \$9.4 million decrease in investment income was due to lower returns on our investments in our credit hedge funds of \$12.6 million partially offset by an increase of \$3.2 million due a realization event in one of our credit PE funds for the three months ended June 30, 2010 as compared to the prior comparative period;

a \$3.9 million increase in net investment income primarily due to a decrease in interest expense primarily due to (i) a decrease of \$1.6 million due to write-offs of deferred financing costs that were recognized during the three months ended June 30, 2009, (ii) a decrease of \$1.4 million due to a decrease in average borrowings as compared to the three months ended June 30, 2009, and (iii) a decrease of \$1.1 million in the amortization of deferred financing costs;



**Table of Contents**

a \$0.4 million increase in net investment income due to an increase in the average cash balance and interest rate over the three months ended June 30, 2010 as compared to the prior comparative period;

a \$0.2 million decrease in net investment income due to dividend income earned primarily from our direct investments in GAGFAH common stock; and

a \$0.8 million decrease in net investment income due to foreign currency translation adjustments;

**Unallocated**

	Six Months Ended June 30,			Three Months Ended June 30,		
	2010	2009	Variance	2010	2009	Variance
Management fees	\$ 3,695	\$	\$ 3,695	\$ 3,695	\$	\$ 3,695
Pre-tax distributable earnings (loss)	\$ (6,705)	\$ (294)	\$ (6,411)	\$ (5,475)	\$ (143)	\$ (5,332)

*Six months ended June 30*

Pre-tax distributable loss increased by \$6.4 million primarily due to:

a \$3.7 million increase in management fees due to the Logan Circle acquisition in April 2010; and

a \$10.1 million increase in operating and acquisition expenses primarily due to the Logan Circle acquisition in April 2010.  
*Three months ended June 30*

Pre-tax distributable loss increased by \$5.3 million primarily due to:

a \$3.7 million increase in management fees due to the Logan Circle acquisition in April 2010; and

a \$9.0 million increase in operating expenses primarily due to the Logan Circle acquisition in April 2010.

**Sensitivity**

For an analysis of the sensitivity of segment revenues to changes in the estimated fair value of the Fortress Fund investments, see Part I, Item 3, Quantitative and Qualitative Disclosures About Market Risk.

**Liquidity and Capital Resources**

Liquidity is a measurement of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain investments, including our capital commitments to our funds, pay compensation, and satisfy our other general business needs including our obligation to pay U.S. federal income tax. In addition, we may use cash to make distributions, particularly the distributions we are required to make to our principals in connection with tax obligations, which can be material. Our primary sources of funds for liquidity consist of cash flows provided by operating activities, primarily the management fees and incentive income paid to us from the Fortress Funds, borrowings under loans, and the potential issuance of debt and equity securities, as well as the investment returns on our principal investments in these funds. Our primary uses of liquidity include operating expenses (which include compensation, rent and interest, among others), working capital

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

expenses, amortization payments under our credit agreement, capital commitments to our funds and tax and tax-related payments and distributions.

The receipt of management fees generally occurs on a fixed and fairly predictable schedule, subject to changes in the NAV of the Fortress Funds (due to performance or capital transactions). From time to time, we may elect, in our discretion, to defer the receipt of management or other fees or reimbursements, to which we are legally entitled, in order to optimize the operations of the underlying managed funds. As of June 30, 2010, the receipt of approximately \$49.7 million of management fees had been deferred, of which \$11.3 million has been subordinated to other liabilities of the related fund and has been fully reserved by us, and the ultimate timing of their payment is currently uncertain. In addition, \$10.7 million of private equity general and administrative expenses had been advanced on behalf of certain funds. The amount of deferred management fees and reimbursements may increase in the future. Also, while we still believe that we will receive these amounts, we now expect to receive payment at a later date than we had previously anticipated. Currently, these developments do not meaningfully impact our liquidity, but if they continue or worsen, they could meaningfully constrain our liquidity in the future.

The timing of receipt of cash flows from other operating activities is in large part dependent on the timing of distributions from our private equity funds and credit PE funds, which are subject to restrictions and to management's judgment.

## Table of Contents

regarding the optimal timing of the monetization of underlying investments, as well as dates specified in our hedge funds' operating documents, which outline the determination and payment of our incentive income, if any. The timing of capital requirements to cover fund commitments is subject to management's judgment regarding the acquisition of new investments by the funds, as well as the ongoing liquidity requirements of the respective funds. The timing of capital requirements and the availability of liquidity from operating activities may not always coincide, and we may make short-term, lower-yielding investments with excess liquidity or fund shortfalls with short-term debt or other sources of capital.

We expect that our cash on hand and our cash flows from operating activities, capital receipts from balance sheet investments and available financing will be sufficient to satisfy our liquidity needs with respect to expected current commitments relating to investments and with respect to our debt obligations over the next twelve months. We estimate that our expected management fee receipts over the next twelve months, a portion of which may be deferred, will be sufficient (along with our cash on hand of \$167.5 million at June 30, 2010, our available draws under our credit facility of \$60.5 million, and capital receipts from our balance sheet investments) to meet our operating expenses (including compensation and lease obligations), required debt amortization payments, tax distribution requirements, and fund capital commitments, in each case to be funded during the next twelve months (see obligation tables below). These uses of cash would not (barring changes in other relevant variables) cause us to violate any of our debt covenants. We believe that the compensation we will be able to pay from these available sources will be sufficient to retain key employees and maintain an effective workforce. We may elect, if we deem it appropriate, to defer certain payments due to our principals and affiliates or raise capital to enable us to satisfy the amortization payments required under our credit agreement or for other working capital needs.

We expect to meet our long-term liquidity requirements, including the repayment of our debt obligations and any new commitments or increases in our existing commitments relating to principal investments, through the generation of operating income (including management fees, a portion of which may be deferred), capital receipts from balance sheet investments and, potentially, additional borrowings and equity offerings. Our ability to execute our business strategy, particularly our ability to form new funds and increase our AUM, depends on our ability to raise additional investor capital within our funds and on our ability to monetize our balance sheet investments, both of which are more challenging in current market conditions than in periods prior to 2008. Furthermore, strategic initiatives and the ability to make principal investments in funds may be dependent on our ability to raise capital at the Fortress level. Decisions by counterparties to enter into transactions with us will depend upon a number of factors, such as our historical and projected financial performance and condition, compliance with the terms of our current credit arrangements, industry and market trends and performance, the availability of capital and our counterparties' policies and rates applicable thereto, the rates at which we are willing to borrow, and the relative attractiveness of alternative investment or lending opportunities. Furthermore, given the current, depressed level of the market price of our Class A shares as well as the illiquidity in the credit market (as described above under "Market Considerations"), raising equity capital could be dilutive to our current shareholders and issuing debt obligations could, while potentially extending maturities, result in significant increases to operating costs, if either were achieved in this market. The level of our share price also limits our ability to use our equity as currency in the potential acquisition of businesses, other companies or assets.

We are a publicly traded partnership and have established a wholly owned corporate subsidiary (FIG Corp.). Accordingly, a substantial portion of our income earned by the corporate subsidiary is subject to U.S. federal income taxation and taxed at prevailing rates. The remainder of our income is allocated directly to our shareholders and is not subject to any corporate level of taxation.

As of June 30, 2010, our material cash commitments and contractual cash requirements were related to our capital commitments to our funds, lease obligations and debt obligations. Our potential liability for the contingent repayment of incentive income is discussed under "Contractual Obligations" below.

### *Capital Commitments*

We determine whether to make capital commitments to our private equity funds and credit PE funds in excess of the minimum required amounts based on a variety of factors, including estimates regarding our liquidity over the estimated time period during which commitments will have to be funded, estimates regarding the amounts of capital that may be appropriate for other funds which we are in the process of raising or are considering raising, and our general working capital requirements.

We generally fund our principal investments in the Fortress Funds with cash, either from working capital or borrowings, and not with carried interest. We do not hold any principal investments in the funds other than through the Fortress Operating Group entities. Our principals do not own any portion of the carried interest in any fund personally. Accordingly, their personal investments in the funds are funded directly with cash.

**Table of Contents**

Our capital commitments to our funds with outstanding commitments as of June 30, 2010 consisted of the following (in thousands):

	<b>Outstanding Commitment</b>
<b><u>Private Equity Funds</u></b>	
Fund I	\$ 36
Fund II	566
Fund III Coinvestment	2
Fund IV	4,053
Fund IV Coinvestment	3
Fund V	25,980
Fund V Coinvestment	4
FRID	796
FHIF	11,446
FECI	1,551
<b><u>Credit PE Funds</u></b>	
Credit Opportunities Fund	17,496
Credit Opportunities Fund II	8,299
Long Dated Value Fund I	460
Long Dated Value Fund II	1,788
Long Dated Value Fund III	177
LDVF Patent Fund	37
Real Assets Fund	30,467
Assets Overflow Fund	132
Karols Development Co	4,759
FTS SIP L.P.	1,140
Japan Opportunity Fund	4,386
Yama 1 and 2 GK	107
Net Lease Fund	449
FCO MA LSS	1,125
FCO MA II	15,200
 Total	 \$ 130,459

*Lease Obligations*

Minimum future rental payments under our operating leases are as follows (in thousands):

July 1 to December 31, 2010	\$ 9,447
2011	13,292
2012	12,522
2013	11,949
2014	11,031
2015	10,610
Thereafter	12,172
 Total	 \$ 81,023

**Table of Contents***Debt Obligations*

As of June 30, 2010, our debt obligations consisted of the amounts outstanding under our credit agreement, as described below.

Increases in the interest rate on our debt obligations, whether through amendments, refinancings, or increases in LIBOR, result in a direct reduction in our earnings and cash flow from operations and, therefore, our liquidity.

The following table presents information regarding our debt obligations (dollars in thousands):

Debt Obligation	Face Amount and Carrying Value		Final Stated Maturity	June 30, 2010	
	June 30, 2010	December 31, 2009		Weighted Average Funding Cost <sup>(1)</sup>	Weighted Average Maturity (Years)
Credit Agreement <sup>(2)</sup>					
Revolving debt <sup>(3)</sup>	\$	\$	May 2012		
Term loan	350,000	350,000	May 2012	3.66%	1.67
Delayed term loan	5,900	47,825	May 2012	3.02%	0.29
<b>Total</b>	<b>\$ 355,900</b>	<b>\$ 397,825</b>		<b>3.65%</b>	<b>1.65</b>

- (1) The weighted average funding cost is calculated based on the contractual interest rate (utilizing the most recently reset LIBOR rate) plus the amortization of deferred financing costs. The most recently reset LIBOR rate was 0.35%.
- (2) 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 interests therein.
- (3) Approximately \$66.9 million was undrawn under the revolving debt facility as of June 30, 2010. The revolving debt facility included a \$25 million letter of credit subfacility of which \$8.1 million was utilized. Lehman Brothers Commercial Paper, Inc., which is committed to fund \$7.2 million (including \$0.8 million of the outstanding letters of credit) of the \$75 million revolving credit facility, has filed for bankruptcy protection, did not fund its portion of the last borrowing under this facility, and it is reasonably possible that it will not fund its portion of the commitments. As a result, \$60.5 million of the undrawn amount was available.

Assuming no EBITDA based required prepayments, our outstanding debt matures as follows as of June 30, 2010 (in thousands).

July 1 - December 31, 2010	\$ 13,974
2011	41,926
2012	300,000
<b>Total</b>	<b>\$ 355,900</b>

As a result of the Nomura transaction, our initial and secondary public offerings, and other transactions, FIG Asset Co. LLC lent excess proceeds of \$371.1 million to FIG Corp. pursuant to a demand note. As of June 30, 2010, the outstanding balance was \$303.6 million, including unpaid interest. This intercompany debt is eliminated in consolidation.

*Covenants*

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Fortress Operating Group is required to prepay its credit agreement upon the occurrence of certain events, including certain asset sales and other dispositions.

The events of default under the credit agreement are typical of such agreements and include payment defaults, failure to comply with credit agreement covenants, cross-defaults to material indebtedness, bankruptcy and insolvency, change of control, and adverse events (as defined in the credit agreement) with respect to our material funds. A default under this agreement would likely have a material, adverse impact on our liquidity and, given the current lack of available credit for refinancing in the market, could threaten our ability to continue as a going concern.

The credit agreement includes customary covenants. We were in compliance with all of these covenants as of June 30, 2010. Among other things, we are prohibited from incurring additional unsubordinated indebtedness or further encumbering our assets, subject to certain exceptions. In addition, Fortress Operating Group must not:

Permit AUM to be less than \$22.0 billion as of the end of each fiscal quarter through December 31, 2009 and \$20.0 billion as of the end of each fiscal quarter thereafter;

Permit the Consolidated Leverage Ratio, as defined in the credit agreement, to be greater than 3.5 to 1.0 for the remainder of the term of the credit agreement;

**Table of Contents**

Permit the aggregate value of investments held, including certain cash, as of any point in time, to be less than the amount equal to the sum of the term loans and the revolving loans (including outstanding letters of credit) then outstanding (the Required Investment Assets );

Permit the aggregate value of Fortress Fund Investments (generally defined in the credit agreement as the stock of Newcastle, Eurocastle and any other publicly traded company pledged as collateral (and any options in respect of such stock), and Fortress Operating Group s interests in the Fortress private equity funds, liquid hedge funds and credit funds and certain other investment funds) to be less than 40% of the Required Investment Assets;

Permit the aggregate value of the sum of (i) the Fortress Fund Investments plus (ii) certain investments in co-investment funds (in the aggregate, Total Investments ) to be less than 60% of the Required Investment Assets (with no single co-investment fund investment exceeding \$75 million);

Make incentive income clawback payments in excess of \$20 million during a calendar year. To date, no clawback payments have been required. See Note 10 to Part I, Item 1 Financial Statements and Supplementary Data Segment Reporting for a further discussion of clawback.

The following table sets forth the financial covenant requirements as of June 30, 2010.

	June 30, 2010 (dollars in millions)			Notes
	Requirement	Actual		
AUM	<sup>3</sup> \$20,000	\$ 41,660		(A)
Consolidated Leverage Ratio	£ 3.50	1.14		(B)
Required Investment Assets	<sup>3</sup> \$366	\$ 871		(C)
Fortress Fund Investments	<sup>3</sup> \$147	\$ 545		(C)
Total Investments	<sup>3</sup> \$220	\$ 701		(C)

(A) Impacted by capital raised in funds, redemptions from funds, and valuations of fund investments.

(B) The consolidated leverage ratio is equal to net debt, as defined, divided by EBITDA, as defined. Net debt and EBITDA are computed as shown below (in millions). EBITDA, as defined, is impacted by the same factors as distributable earnings, except EBITDA is not impacted by changes in clawback reserves or gains and losses, including impairment, on investments.

	June 30, 2010
Outstanding debt (D)	\$ 358.3
Plus: Outstanding letters of credit	8.1
Less: Cash (up to \$50 million)	(50.0)
Net debt	\$ 316.4

	Twelve Months Ended June 30, 2010
Fortress Operating Group GAAP net income (loss) after non-controlling interests	\$ (970.5)
Depreciation and amortization, interest expense and income taxes	30.3
Extraordinary or non-recurring losses	
Incentive Income Adjustment	100.8

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Other Income Adjustment	(59.5)
Compensation expenses recorded in connection with the assignment of Castle	
Options and Stock Based Compensation	1,186.8
Accrued employee profit sharing related to NIH incentive compensation minus cash payments made with respect to such employee profit sharing	(9.8)
Income (loss) allocable to, or resulting from distributions to, the Principals or their assignees	
Earnings on deferred fee arrangements, net of employees' share	
Extraordinary or non-recurring gains	
<b>EBITDA</b>	<b>\$ 278.1</b>

(C) Impacted by capital investments in funds and the valuation of such funds' investments.

(D) Includes \$2.4 million of intercompany debt (eliminated in consolidation) which meets the definition of debt under the credit agreement. Fortress expects to comply with these covenants as of the applicable testing dates. However, as a result of recent market conditions and their impact on Fortress, it is possible that we may not be able to comply with one or more of these covenants if conditions worsen over time. As a result of the amortization requirements, we may take steps to ensure that we are able to make the required periodic cash amortization payments, including (i) deferring payments to our Principals and affiliates in order to preserve cash, including payments to our Principals under the tax receivable agreement, and (ii) considering potential capital raise transactions in order to increase investments, reduce debt, or a combination of the two options.



---

## Table of Contents

This summary is qualified by reference to our credit agreement, a copy of which, including all amendments thereto, has been filed with the SEC.

### *Dividends / Distributions*

During the six months ended June 30, 2010, Fortress Operating Group declared distributions of \$35.7 million to the principals and RPU holder in connection with tax obligations.

### *Cash Flows*

Our primary cash flow activities are: (i) generating cash flow from operations, (ii) making investments in Fortress Funds, (iii) meeting financing needs through, and making required amortization payments under, our credit agreement, and (iv) distributing cash flow to equity holders, as applicable.

As described above in Results of Operations, our AUM has changed throughout the periods reflected in our financial statements included in this Quarterly Report on Form 10-Q. This change is a result of the Fortress Funds raising and investing capital, and generating gains from investments, offset by redemptions, capital distributions and losses.

Our dividend policy has certain risks and limitations, particularly with respect to liquidity. Although we may pay dividends in accordance with our stated dividend policy, we may not pay the amount of dividends suggested by our policy, or at all, if, among other things, we do not have the cash necessary to pay the intended dividends, or if our board of directors determines it would be prudent to reduce or eliminate future dividend payments. To the extent we do not have cash on hand sufficient to pay dividends, we may borrow funds to pay dividends, but we are not obligated to do so. By paying cash dividends rather than investing that cash in our future growth, we risk slowing the pace of our growth, or not having a sufficient amount of cash to fund our operations or unanticipated capital expenditures, should the need arise.

### Operating Activities

Our net cash flow provided by (used in) operating activities was \$98.0 million and (\$50.2) million during the six months ended June 30, 2010 and 2009, respectively.

### Operating Activities Comparative

Cash received for management fees decreased by \$20.3 million from \$191.7 million in 2009 to \$171.4 million in 2010. Management fees are based on average AUM, which increased from 2009 to 2010 (private equity funds decreased by (\$1.2) billion, Castles decreased by less than (\$0.1) billion, liquid hedge funds decreased by (\$0.7) billion, credit hedge funds increased by \$1.3 billion, and credit PE funds increased by \$0.9 billion) as a result of capital raising, including new fund formation, capital acquisitions and returns offset by redemptions, capital distributions and losses. However, the impact of this increase in AUM was offset by approximately \$49.7 million of management fees that were past due at June 30, 2010 as discussed in Liquidity and Capital Resources above.

Incentive income is calculated as a percentage of profits earned by the Fortress Funds or is based on profitable realization events within private equity funds and credit PE funds. Severe market conditions resulted in lower fund performance and reduced realizations in 2009 and thus an increase of \$131.5 million in cash received for incentive income from 2009 to 2010 occurred as conditions improved and realizations increased.

Cash paid for compensation decreased by \$19.1 million from the year to date period ended June 30, 2009 compared to June 30, 2010.

Cash paid for interest decreased approximately \$1.5 million primarily due to a lower average debt balance of \$378.0 million in 2010 compared to \$620.4 million in 2009. The weighted average interest rate increased to 2.77% in 2010 as compared to 2.74% in 2009.

### Investing Activities

Our net cash flow provided by (used in) investing activities was (\$0.6) million and (\$13.4) million during the six months ended June 30, 2010 and 2009, respectively. Our investing activities primarily included: (i) contributions to equity method investees of (\$31.7) million and (\$39.3) million during the six months ended June 30, 2010 and 2009, respectively, (ii) distributions of capital from equity method investees of \$46.1 million and \$27.5 million during the six months ended June 30,



---

## **Table of Contents**

2010 and 2009, respectively, and (iii) purchases of fixed assets, net of proceeds from the disposal of fixed assets, of (\$1.5) million and (\$1.7) million during the six months ended June 30, 2010 and 2009, respectively. In addition, Fortress used a net \$13.5 million of cash during the six months ended June 30, 2010 on acquisitions, primarily Logan Circle Partners, L.P.

### **Financing Activities**

Our net cash flow provided by (used in) financing activities was (\$127.0) million and (\$109.3) million during the six months ended June 30, 2010 and 2009, respectively. Our financing activities primarily included (i) distributions made to principals, including those classified within principals and others interests in consolidated subsidiaries, of (\$41.7) million and (\$30.6) million during these periods, respectively, (ii) distributions to employees related to their interests in consolidated subsidiaries of (\$43.4) million and (\$4.1) million during these periods, respectively, and (iii) our net borrowing and repayment activity. In addition, Fortress completed a \$219.5 million offering of Class A shares during the six months ended June 30, 2009.

### **Critical Accounting Policies**

#### *Consolidation*

The analysis as to whether to consolidate an entity is subject to a significant amount of judgment. Some of the criteria considered are the determination as to the degree of control over an entity by its various equity holders, the design of the entity, how closely related the entity is to each of its equity holders, the relation of the equity holders to each other and a determination of the primary beneficiary in entities in which we have a variable interest. These analyses involve estimates, based on the assumptions of management, as well as judgments regarding significance and the design of the entities.

#### *Revenue Recognition on Incentive Income*

Incentive income is calculated as a percentage of the profits earned by the Fortress Funds subject to the achievement of performance criteria. Incentive income from certain of the private equity funds and credit PE funds we manage is subject to contingent repayment (or clawback) and may be paid to us as particular investments made by the funds are realized. If, however, upon liquidation of a fund the aggregate amount paid to us as incentive income exceeds the amount actually due to us based upon the aggregate performance of the fund, the excess is required to be returned by us (i.e. clawed back) to that fund. We have elected to adopt the preferred method of recording incentive income subject to contingencies. Under this method, we do not recognize incentive income subject to contingent repayment until all of the related contingencies have been resolved. Deferred incentive income related to a particular private equity fund, or credit PE fund, each of which has a limited life, would be recognized upon the termination of a private equity fund, or credit PE fund, or when distributions from a fund exceed the point at which a clawback of a portion or all of the historic incentive income distributions could no longer occur. Recognition of incentive income allocated to us prior to that date is deferred and recorded as a deferred incentive income liability. For GAAP purposes, the determination of when incentive income is recognized as income is formulaic in nature, resulting directly from each fund's governing documents.

#### *Profit Sharing Arrangements*

Pursuant to employment arrangements, certain of Fortress's employees are granted profit sharing interests and are thereby entitled to a portion of the incentive income realized from certain Fortress Funds, which is payable upon a realization event within the respective funds. Accordingly, incentive income resulting from a realization event within a fund gives rise to the incurrence of a profit sharing obligation. Amounts payable under these profit sharing plans are recorded as compensation expense when they become probable and reasonably estimable.

For profit sharing plans related to hedge funds, where incentive income is received on a quarterly or annual basis, the related compensation expense is accrued during the period for which the related payment is made.

For profit sharing plans related to private equity funds and credit PE funds, where incentive income is received as investments are realized but is subject to clawback (see Revenue Recognition on Incentive Income above), although Fortress defers the recognition of incentive income until all contingencies are resolved, accruing expense for employee profit sharing is based upon when it becomes probable and reasonably estimable that incentive income has been earned and therefore a profit sharing liability has been incurred. Based upon this policy, the recording of an accrual for profit sharing expense to employees generally precedes the recognition of the related incentive income revenue. As a result, private equity and credit PE incentive income realization events, which benefit Fortress economically, cause our GAAP earnings to decline in the short term as expense is recognized before the corresponding revenue. Such profit sharing expense may be reversed upon determination that the expense is no longer probable of being incurred based on the performance of the fund.



---

## **Table of Contents**

Our determination of the point at which it becomes probable and reasonably estimable that incentive income will be earned and therefore a corresponding profit sharing expense should be recorded is based upon a number of factors, the most significant of which is the level of realized gains generated by the underlying funds that may ultimately give rise to incentive income payments. Accordingly, profit sharing expense is generally recorded upon realization events within the underlying funds. A realization event has occurred when an investment within a fund generates proceeds in excess of its related invested capital, such as when an investment is sold at a gain. Changes in the judgments and estimates made in arriving at the appropriate amount of profit sharing expense accrual could materially impact net income.

For further information on amounts paid and payable in the future under our profit sharing arrangements, please see Note 2 to Part I, Item 1, Financial Statements – Management Agreements and Fortress Funds.

### *Valuation of Investments*

Our investments in the Fortress Funds are recorded based on the equity method of accounting. The Fortress Funds themselves apply specialized accounting principles for investment companies. As such, our results are based on the reported fair value of the investments held by the funds as of the reporting date with our pro rata ownership interest (based on our principal investment) in the changes in each fund's NAV reflected in our results of operations. Fair value generally represents the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. We are the manager of these funds and in certain cases participate in the valuation of underlying investments, many of which are illiquid and/or without a public market. The fair value of these investments is generally estimated based on either values provided by independent valuation agents, who use their own proprietary valuation models, or proprietary models developed by us, which include discounted cash flow analyses, public market comparables, and other techniques and may be based, at least in part, on independently sourced market parameters. The material estimates and assumptions used in these models include the timing and expected amount of cash flows, the appropriateness of discount rates used, and, in some cases, the ability to execute, timing of, and estimated proceeds from expected financings. Significant judgment and estimation goes into the selection of an appropriate valuation methodology as well as the assumptions which generate these models, and the actual values realized with respect to investments could be materially different from values obtained based on the use of those estimates. The valuation methodologies applied impact the reported value of our investments in the Fortress Funds in our consolidated financial statements.

### *Private Equity Funds*

Under the valuation policies and guidelines of our private equity funds, investments are categorized into two types of securities: those for which there is a market quotation and those for which there is no market quotation. Securities for which there is a market quotation are valued at their quoted market price. A discount may be applied to those securities with sale restrictions. Securities for which there is no market quotation are referred to as private securities and are valued at fair value. Our guidelines state that the fair values of private securities are generally based on the following methods:

1. Public market transactions of similar securities
2. Private market transactions of similar or identical securities
3. Analytical methods

Our private equity funds have not to date based a valuation of a private security solely upon public or private market transactions in a similar security. There have been no circumstances to date in which a security in a public market transaction, or a private market transaction of which we were aware, has been considered to be sufficiently similar to a private security owned by one of our private equity funds to be used as the measure of valuation for such private security investment.

Our private equity funds have used the price of private market transactions in identical securities as a valuation method for investments. In cases in which there has been a significant private transaction in a private security held by our private equity funds, the value of private equity fund investments in the private security are based upon the price of such recent private transaction in that security and no sensitivity analysis is used.

If the fair value of private security investments held by our private equity funds cannot be valued by reference to a public or private market transaction, then the primary analytical methods used to estimate the fair value of such private securities are the discounted cash flow method, by

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

reference to performance statistics of similar public companies (for example, EBITDA multiples) or the use of third party valuations. Sensitivity analysis is applied to the estimated future cash flows using various factors depending on the investment, including assumed growth rates (in cash flows), capitalization rates (for determining terminal values) and appropriate discount rates based on the investment to determine a range of reasonable values. The valuation based on the inputs determined to be the most probable is used as the fair value of the investment.

## **Table of Contents**

### Liquid Hedge Funds

The majority of the investments in our liquid hedge funds are valued based on quoted market prices. Investments valued based on other observable market parameters in our liquid hedge funds include interest rate swaps and swaptions, equity swaps and foreign exchange swaps which are valued by the independent fund administrator using models with significant observable market parameters. The fair value of interest rate swaps and swaptions is calculated using the current market yield of the relevant interest rate durations and an appropriate discount rate to determine a present value. The fair value of equity swaps and foreign exchange swaps is calculated using the market price of the underlying stock or foreign exchange pair, plus the financing cost of carrying the transaction. The fair value of these investments is also confirmed independently with the counterparty to the transaction. Investments valued using methods, including internal models, with significant unobservable market parameters consist primarily of investments in other funds and certain illiquid securities. Counterparty risk is also considered.

### Credit Hedge Funds

In our credit hedge funds, investments are valued using quoted market prices, to the extent available. Independent valuation agents are used by our credit hedge funds to provide estimates of the fair value of investments, other than investments in other funds, for which quoted market prices are not available. For these investments, we understand that the independent valuation agents use some or all of the following methods and techniques to estimate the fair value of the relevant type of investments:

Private loans - The most common method used to value private loans is a discounted cash flow analysis. In this method, the estimated future payments to be made by the borrower under the loan agreement are discounted to the present using a discount rate appropriate to the risk level of the borrower and current market interest rates.

If it is likely that a borrower will not be able to repay a loan in full, the loan may be valued by estimating how much the borrower will be able to repay based on obtaining refinancing from a new lender. Under this method, the borrower's business must be examined in detail, and then compared to known loans in the market to estimate how much the borrower will likely be able to borrow, and therefore repay under the existing loan. If the amount likely to be able to be refinanced is less than the total payments due under the loan, the fair value of the loan will be reduced.

Another method used to value loans that may not be repaid in full is to value the total amount of assets of the borrower that might be sold to raise proceeds to repay the loan (and debt, if any, that has a higher claim against assets) if necessary. Under this method, all assets of the borrower must be analyzed and valued. If the total value is less than the total payments due under the loan (and debt, if any, that has a higher claim against assets), the fair value of the loan will be reduced.

Asset-backed securities and collateralized debt obligations for which there are no quoted market prices are valued using a discounted cash flow analysis based on the estimated cash flows to be generated by the relevant underlying assets and the appropriate interest rate based on the nature of the underlying assets.

Real estate is usually valued based on sales of comparable property. The value of real estate which is net leased is also influenced by the credit quality of major tenants, as their ability to make lease payments is relevant to the value of the property under lease.

Investments in other funds are valued primarily based on the net asset values provided by the fund managers of those funds.

Investments valued using methods, including internal models, with significant unobservable market parameters consist primarily of investments in other funds and certain illiquid investments.

### Credit PE Funds

Investments held within these funds are valued in a consistent manner with either the private equity funds or credit hedge funds, as applicable depending on the nature of the investment.

### Traditional Asset Management Business

Investments made within this business are valued in a consistent manner with our funds' policies as described above.





**Table of Contents****Sensitivity**

Changes in the fair value of our funds' investments would impact our results of operations as described in Part I, Item 3, Quantitative and Qualitative Disclosures About Market Risk.

As discussed above, the determination of investment fair values involves management's judgments and estimates. The degree of judgment involved is dependent upon the availability of quoted market prices or observable market parameters. The following table summarizes the investments held by the Fortress Funds by valuation methodology as of June 30, 2010. As of June 30, 2010, revenues from our traditional asset management business are not materially sensitive to reasonably expected changes in market risk factors.

The categories displayed below correspond directly with the disclosures which are required under fair value accounting guidance.

	Basis for Determining Fair Value	Private	Liquid Hedge Funds		Credit Hedge Funds	Credit PE Funds	Total Investment Company Holdings
		Equity Funds	Long	Short			
1.	Quoted market prices	8%	80%	66%	2%	4%	14%
2.	Other observable market parameters	7%	10%	34%	5%	1%	5%
3A.	Third party pricing sources with significant unobservable market parameters (A)	10%	9%	0%	91%	76%	48%
3B.	Internal models with significant unobservable market parameters	75%	1%	0%	2%	19%	33%
Total		100%	100%	100%	100%	100%	100%

(A) Primarily represents valuations based on third party pricing services, certain broker quotes, and third party fund managers.

As of June 30, 2010, \$8.0 billion of investments in our private equity funds, \$0.0 billion of investments in our liquid hedge funds, \$0.2 billion of investments in our credit hedge funds, and \$0.7 billion of investments in our credit PE funds are valued by internal models with significant unobservable market parameters. A 10% increase or decrease in the value of investments held by the Fortress Funds valued at level 3 (A or B) would have had the following effects on our results of operations on an unconsolidated basis for the six months ended June 30, 2010, consistent with the table above:

	Private Equity Funds	Liquid Hedge Funds	Credit Hedge Funds	Credit PE Funds
Management fees, per annum on a prospective basis	\$2.6 million or (\$4.1 million) (A)	\$1.0 million	\$16.7 million	\$0.0 million or (\$0.2 million) (A)
Incentive income	N/A (B)	N/A (C)	N/A (C)	N/A (B)
Earnings from equity method investees	\$43.5 million	\$0.6 million	\$15.1 million	\$7.0 million

Note: The tables above exclude non-investment assets and liabilities of the funds, which are not classified in the fair value hierarchy. Such net assets may be material, particularly within the hedge funds.

(A) Private equity fund and credit PE fund management fees would be generally unchanged as they are generally not based on the value of the funds, but rather on the amount of capital invested in the funds. However, if the NAV of a portfolio company of certain private equity funds or credit PE funds is reduced below its invested capital, there would be a reduction in management fees. As of June 30, 2010, \$2.7 billion of such portfolio companies valued at level 3 (A or B) were carried at or below their invested capital and are primarily in funds which are no longer in their commitment period. Management fees are generally calculated as of certain reset dates. The amounts disclosed show what the estimated effects would be to management fees over the next year assuming June 30, 2010 is the current reset date.

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

- (B) Private equity fund and credit PE fund incentive income would be unchanged as it is not recognized until received and all contingencies are resolved. Furthermore, incentive income would be based on the actual price realized in a transaction, not based on a valuation.
  
- (C) Hedge fund incentive income would be unchanged as it is not recognized until all contingencies are resolved in the fourth quarter (and Value Recovery Funds do not pay any current incentive income). Incentive income is generally not charged on amounts invested by credit hedge funds in funds managed by external managers.

**Table of Contents***Income Taxes*

FIG Corp. has recorded a significant deferred tax asset, primarily in connection with the Nomura transaction and the IPO. These transactions resulted in the basis of Fortress Operating Group's net assets being in excess of its book basis, which will result in future tax deductions. A substantial portion of this asset is offset by a liability associated with the tax receivable agreement with our Principals.

The realization of the deferred tax assets is dependent on the amount of our future taxable income before deductions related to the establishment of the deferred tax asset. The deferred tax asset is comprised of a portion that would be realized in connection with future ordinary income and a portion that would be realized in connection with future capital gains.

We project that we will have sufficient future taxable ordinary income in the normal course of business without any projected significant change in circumstances to fully realize the portion of the deferred tax asset that would be realized in connection with future ordinary income. Our projections do not include material changes in AUM or incentive income from the current levels which, due to the challenging market conditions, have declined from historical levels. However, the projections do contain an estimated marginal growth assumption in years beyond 2010. Based on our historical and projected taxable income, we have concluded that the realization of the portion of the deferred tax asset that would be realized in connection with future taxable ordinary income is more likely than not. If our estimates change in the future and it is determined that it is more likely than not that some portion, or all, of this portion of the deferred tax asset will not be realized, a valuation allowance would be recorded for that portion. However, in most cases, any tax expense recorded in connection with the establishment of a valuation allowance or the reversal of a deferred tax asset would be partially offset by other income recorded in connection with a corresponding reduction of a portion of the tax receivable agreement liability (see below). The following table sets forth our estimated federal taxable ordinary income for 2007, 2008 and 2009 before deductions relating to the establishment of the deferred tax assets, excluding deferred tax assets arising from equity-based compensation, as well as the average of such amount needed over the approximate period of the deductibility (approximately 15 years from the date of establishment, based on the amortization period of the tax basis intangible assets recorded) in order to fully realize the portion of the deferred tax asset that would be realized in connection with future ordinary income (in millions):

2007	\$ 74.9
2008	\$ 48.0
2009 Estimated	\$ 51.2
2010 - 2015: Average Required	\$ 51.7
2016 - 2021: Average Required	\$ 85.5

Based on the effects of the continuing challenging credit conditions, we have made an assessment of the realizability of the portion of the deferred tax asset that would only be realized in connection with future capital gains. We have established a full valuation allowance for this portion of the deferred tax asset as management does not believe that the projected generation of material taxable capital gains is sufficiently assured in the foreseeable future. The establishment of the valuation allowance resulted in a reduction of the obligations associated with the tax receivable agreement and a corresponding reduction of the deferred tax asset.

For further information on our effective tax rate, and the tax receivable agreement, see Note 5 to our financial statements in Part I, Item 1, Financial Statements – Income Taxes and Tax Related Payments. Our effective tax rate for GAAP reporting purposes may be subject to significant variation from period to period. In addition, legislation has been introduced in the United States, which, if enacted in its current or similar form, could cause us to incur a material increase in our tax liability. See Part II, Item 1A, Risk Factors – Risks Related to Taxation. Several items of tax legislation are currently being considered which, if enacted, could materially affect us, including by preventing us from continuing to qualify as a partnership for U.S. federal income tax purposes. Our structure also is subject to potential judicial or administrative change and differing interpretations, possibly on a retroactive basis.

*Equity-Based Compensation*

We currently have several categories of equity-based compensation. The aggregate fair value of each of the RSU grants that 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 our company adjusted for the expected effects of the grants on turnover, if any, and other factors in the judgment of management. The estimated forfeiture factor is updated at each reporting date.

---

## **Table of Contents**

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 we do not have sufficient historical share performance to use our own historical volatility, adjusted for management's judgment regarding our expected volatility. Since our IPO in February 2007, our actual volatility has exceeded the volatility assumption used. To the extent that this trend continues, and management's judgment concerning volatility is changed, we 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 our 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 following elements of the accounting for equity-based compensation are subject to significant judgment and estimation:

the determination of the grant date;

the estimated forfeiture factor;

the discount related to RSUs which do not entitle the recipients to dividend equivalents prior to the delivery of Class A shares. This discount was based on the estimated present value of dividends to be paid during the service period, which in turn was based on an estimated initial dividend rate, an estimated dividend growth rate and a risk-free discount rate of like 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. This discount 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, term, dividend rate and risk-free discount rate; and

the estimated fair value of the LTIP awards, which was estimated using a Monte Carlo simulation valuation model, with the following assumptions: volatility, term, dividend rate, and risk-free discount rate.

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. Increases in the assumed forfeiture factor would decrease compensation expense. Increases in the volatility assumption would (i) decrease compensation expense related to RSUs with no service conditions since the discount for delayed delivery would have increased, and (ii) increase compensation expense related to the LTIP since the value of the LTIP would have increased. Increases in the assumed risk-free rate would (i) decrease compensation expense related to RSUs which do not entitle recipients to dividend equivalents since the estimated value of the foregone dividends would have increased, thereby increasing the discount related to their non-receipt, (ii) decrease compensation expense related to RSUs with no service conditions since the discount for delayed delivery would have increased, and (iii) increase compensation expense related to the LTIP since the value of the LTIP would have increased. Except for the forfeiture factor, changes in these assumptions will only affect awards made in the future and awards whose accounting is impacted by changes in their fair value (generally those to non-employees, known as liability awards).

## **Recent Accounting Pronouncements**

In June 2009, the FASB issued new guidance on consolidation which became effective for Fortress on January 1, 2010. This guidance changes the definition of a variable interest entity (VIE) and changes the methodology to determine who is the primary beneficiary of, or in other words who consolidates, a VIE. Generally, the changes are expected to cause more entities to be defined as VIEs and to shift consolidation to those entities that exercise day-to-day control over the VIEs, such as investment managers. In February 2010, the FASB updated this guidance to defer its application to certain managed entities, particularly investment companies and similar entities. As a result, this guidance had no material impact on our financial position, results of operations or liquidity.

## **Market Risks**

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Our predominant exposure to market risk is related to our role as investment manager for the Fortress Funds and the sensitivities to movements in the fair value of their investments on management fee and incentive income revenue, as well as on returns on our principal investments in such funds. For a discussion of the impact of market risk factors on our financial instruments refer to Part I, Item 3 Quantitative and Qualitative Disclosures About Market Risk and Critical Accounting Policies Valuation of Investments above.

---

## **Table of Contents**

### **Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements.

See Note 9 to Part I, Item 1 Financial Statements Commitments and Contingencies for a discussion of our commitments and contingencies.

### **Contractual Obligations**

As of June 30, 2010, our material contractual obligations are our capital commitments to our funds, our lease obligations and our debt obligations as described above. Furthermore, we have potential clawback obligations with respect to our private equity deferred incentive income received to date.

Our future contractual obligations decreased from \$1.1 billion as of December 31, 2009 to \$1.0 billion as of June 30, 2010.

Our debt obligations payable decreased from \$420.4 million as of December 31, 2009 to \$373.6 million as of June 30, 2010, including estimates for interest payments. This decrease was primarily attributable to the repayment of \$41.9 million of the delayed term loan.

The amount of clawback that would be due based on a liquidation of the related Fortress Funds at their net asset value as of June 30, 2010, which we refer to as intrinsic clawback, was \$83.4 million as compared to \$98.7 million at December 31, 2009. The decrease is primarily a result of the net returns earned by the related Fortress Funds during the six months ended June 30, 2010.

Our outstanding capital commitments, including our commitments to our funds, have decreased from \$131.4 million as of December 31, 2009 to \$130.5 million as of June 30, 2010. This decrease is primarily attributable to \$19.3 million and \$7.1 million in contributions we made to Fund V and the Real Assets Fund, respectively, during the six months ended June 30, 2010. These decreases were partially offset by our capital commitment to our newly formed FCO MA II fund of \$15.2 million, an increase of \$8.9 million due to the net effect of recallable capital distributions from the Credit Opportunities Fund, as well as a \$1.3 million increase in our capital commitment to our Japan Opportunity Fund.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our predominant exposure to market risk is related to our role as investment manager for the Fortress Funds and the sensitivities to movements in the fair value of their investments on management fee and incentive income revenue and investment income (loss).

The fair value of the financial assets and liabilities of the Fortress Funds may fluctuate in response to changes in the value of securities, foreign exchange, commodities and interest rates. Fluctuations in the fair value of the Fortress Funds will continue to directly affect the carrying value of our investments in the Fortress Funds and thereby our earnings (losses) from equity method investees, as well as the management fees and incentive income we record, to the extent that they are earned based on fair value or NAV. As of June 30, 2010, revenues from our traditional asset management business are not materially sensitive to reasonably expected changes in market risk factors.

Risks are analyzed across funds from the bottom up and from the top down with a particular focus on asymmetric risk. Management gathers and analyzes data, monitors investments and markets in detail, and constantly strives to better quantify, qualify and circumscribe relevant risks.

Although the Fortress Funds share many common themes, each segment within the investment companies runs their own investment and risk management process subject to the company's overall risk tolerance and philosophy:

the investment process of our private equity funds involves a detailed analysis of potential acquisitions, and asset management teams assigned to oversee the strategic development, financing and capital deployment decisions of each portfolio investment;

our credit hedge funds, credit PE funds and Castles perform credit and cash-flow analysis of borrowers, tenants and credit-based assets, and have asset management teams that monitor covenant compliance by, and relevant financial data of, borrowers, tenants and other obligors, asset pool performance statistics, tracking of cash payments relating to investments, and ongoing analysis of the credit

status of investments; and

our liquid hedge funds continuously monitor a variety of markets for attractive trading opportunities, applying a number of traditional and customized risk management metrics to analyze risk related to specific assets or portfolios, as well as fund-wide risks.

**Table of Contents**

Each segment has an institutional risk management process and related infrastructure to address these risks. The following table summarizes our financial assets and liabilities that may be impacted by various market risks such as equity prices, interest rates and exchange rates as of June 30, 2010 (in thousands):

<b>Assets</b>	
Investments	\$ 869,432
<b>Liabilities</b>	
Debt obligations payable	\$ 355,900

Since Fortress's investments in the various Fortress Funds are not equal, Fortress's risks from a management fee and incentive income perspective (which mirror the funds' investments) and its risks from an investment perspective are not proportional.

*Fortress Funds' Market Risk Impact on GAAP Management Fees*

Our management fees are generally based on either: (i) capital commitments to a Fortress Fund, (ii) capital invested in a Fortress Fund, or (iii) the NAV of a Fortress Fund, as described in our historical consolidated financial statements. Management fees will only be impacted by changes in market risk factors to the extent they are based on NAV. These management fees will be increased (or reduced) in direct proportion to the impact of changes in market risk factors on the investments in the related funds and would occur only in periods subsequent to the change, as opposed to having an immediate impact. The proportion of our management fees that are based on NAV is dependent on the number and types of Fortress Funds in existence and the current stage of each fund's life cycle. As of June 30, 2010, approximately 44% of the management fees earned from our alternative investment businesses were based on the NAV of the applicable funds.

For private equity funds and certain credit PE funds, management fees are charged on committed capital during the investment period of a new fund, and then generally on invested capital after the investment period, with the exception of private equity funds formed after March 2006. For private equity funds formed after March 2006 that are no longer in the investment period, management fees are earned on NAV with respect to investments in publicly traded entities. Reductions in net asset value below invested capital for any fund investment will also cause reductions in management fees.

For Castles, management fees are not calculated based on NAV but instead a fee is charged based on the funds' contributed capital.

For hedge funds, other than the Value Recovery Funds, management fees are based on their NAV, which in turn is dependent on the estimated fair values of their investments. For the Value Recovery Funds, management fees are based on realizations which are not dependent on current estimated fair value; for certain managed assets within the Value Recovery Funds, management fees are dependent on a defined gross asset value which is not directly dependent on current estimated fair value.

Changes in values of investments could indirectly affect future management fees by, among other things, reducing the funds' access to capital or liquidity and their ability to currently pay management fees.

*Fortress Funds' Market Risk Impact on GAAP Incentive Income*

Our incentive income is generally based on a percentage of profits of the various Fortress Funds subject to the achievement of performance criteria. Our incentive income will be impacted by changes in market risk factors. However, several major factors will influence the degree of impact: (i) the performance criteria for each individual fund in relation to how that fund's results of operations are impacted by changes in market risk factors, (ii) whether such performance criteria are annual or over the life of the fund, (iii) to the extent applicable, the previous performance of each fund in relation to its performance criteria, and (iv) whether each fund's incentive income is subject to contingent repayment. As a result, the impact of changes in market risk factors on incentive income will vary widely from fund to fund, as summarized below, and is heavily dependent on the prior performance of each fund, and is therefore not readily predicted or estimated.



Incentive income from our private equity funds and credit PE funds is not recorded as revenue but instead is deferred under GAAP until the related clawback contingency is resolved. Deferred incentive income, which is subject to contingencies, will be recognized as revenue to the extent it is received and all the associated contingencies are resolved. Assuming that the deferred incentive income earned to date would be equal to what would be recognized when all contingencies are resolved, a 10% increase or decrease in the fair values of investments held by all of the private equity funds and credit PE funds where incentive income is subject to contingencies at June 30, 2010 would increase or decrease future incentive income by \$65.4 million or (\$65.6 million), respectively; however, this would have no effect on our current reported financial condition or results of operations.

**Table of Contents**

Incentive income from the Castles is not impacted by changes in the fair values of their investments, except to the extent they represent impairment, since these changes do not impact the measure of current operating results (i.e. FFO in excess of specified returns to the company's shareholders) upon which the incentive income is calculated. The definition of FFO excludes unrealized changes in the values of the Castles' investments (primarily real estate, loans and securities), except for minor items (for example, the unrealized gain or loss on non-hedge derivatives which make up only an immaterial portion of their assets).

Incentive income from our hedge funds is directly impacted by changes in the fair value of their investments. Incentive income from certain of our hedge funds is earned based on achieving annual performance criteria. For certain hedge funds, a 10% decrease to the NAV of the funds on June 30, 2010 would have resulted in a loss to investors for the quarter. In future periods, this loss could create, or cause a fund to fall further below, a high water mark (minimum future return to recover the loss to the investors) for our funds performance which would need to be achieved prior to any incentive income being earned by us. The Value Recovery Funds only pay incentive income if aggregate realizations exceed a certain threshold and, therefore, this potential incentive income (none of which has been recorded to date) is not impacted by changes in fair value.

*Fortress Funds' Market Risk Impact on GAAP Investment Income*

Our investments in the Fortress Funds, other than the Castles, are accounted for under the equity method. To the extent they are investment companies, our investments are directly affected by the impact of changes in market risk factors on the investments held by such funds, which could vary significantly from fund to fund.

*Market Risk - Quantitative Analysis*

The following table presents information on the impact to Fortress of a 10% change in the net asset values of the Fortress Funds at June 30, 2010 (in millions).

	10% Positive Change					
	GAAP Revenues			Segment Revenues (A)		
	Management Fees (B)	Incentive Income	Earnings from Equity Method Investees (C)	Management Fees (B)	Incentive Income	Investment Income
Private Equity Funds	\$ 3.9	\$ N/A (E)	\$ 49.0	\$ 3.9	\$ N/A (E)	\$ N/A
Castles (D)	N/A	N/A	N/A	N/A	N/A	N/A
Liquid Hedge Fund	7.5	N/A (G)	0.8	7.5	56.8	0.5
Credit Hedge Funds	12.1	N/A (G)	17.9	12.1	56.6	10.6
PE Funds		N/A (E)	6.9		N/A (E)	N/A
Total	\$ 23.5	\$	\$ 74.6	\$ 23.5	\$ 113.4	\$ 11.1

	10% Negative Change					
	GAAP Revenues			Segment Revenues (A)		
	Management Fees (B)	Incentive Income	Earnings from Equity Method Investees (C)	Management Fees (B)	Incentive Income	Investment Income
Private Equity Funds	\$ (5.4)	\$ N/A (E)	\$ (49.0)	\$ (5.4)	\$ N/A (E) (F)	\$ N/A (F)
Castles (D)	N/A	N/A	N/A	N/A	N/A	N/A (F)
Liquid Hedge Fund	(7.5)	N/A (G)	(0.8)	(7.5)	(3.7)	(0.5)
Credit Hedge Funds	(12.1)	N/A (G)	(17.9)	(12.1)	(5.3)	(10.6)
PE Funds	(0.3)	N/A (E)	(6.9)	(0.3)	N/A (E) (F)	N/A (F)
Total	\$ (25.3)	\$	\$ (74.6)	\$ (25.3)	\$ (9.0)	\$ (11.1)

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

- (A) See Management's Discussion and Analysis of Financial Condition and Results of Operations - Segment Analysis for a discussion of the differences between GAAP and segment basis revenues.
  
- (B) Changes in management fees represent an annual change for the one year period following the measurement date assuming there is no change to the investments held by the funds during that period. For private equity funds and credit PE funds, it assumes that the management fees reset as of

**Table of Contents**

the reporting date. Private equity fund and credit PE fund management fees would be generally unchanged as, for investments in non-publicly traded securities, they are not based on the value of the funds, but rather on the amount of capital invested in the funds. However, if the NAV of a portfolio company of certain private equity funds or credit PE funds is reduced below its invested capital, there would be a reduction in management fees. As of the reporting date, \$3.0 billion of such private equity fund or credit PE fund portfolio companies were carried at or below their invested capital and are primarily in funds which are no longer in their commitment period.

- (C) The changes presented do not include any effect related to our direct investment in GAGFAH common stock. A 10% increase (decrease) in the equity price of GAGFAH's common shares would affect our unrealized gains and losses by \$4.1 million.
- (D) Our investments in the Castles are held at fair value, based on the market value of the shares we own. Gains (losses) on our shares in the Castles and options granted to us by the Castles are affected by movements in the equity price of the shares. A 10% increase (decrease) in the equity price of the shares would affect unrealized gains and losses by approximately \$0.5 million. A 10% increase (decrease) in the market value of our investment in Eurocastle convertible debt would affect unrealized gains and losses by \$0.1 million. Furthermore, the Castles' management fees and incentive income are not directly impacted by changes in the fair value of their investments (unless the changes are deemed to be impairment, which could impact incentive income).
- (E) For GAAP Revenues, private equity fund and credit PE fund incentive income would be unchanged as it is not recognized until received and all contingencies are resolved. Furthermore, incentive income would be based on the actual price realized in a transaction, not based on a valuation. For Segment Revenues, private equity fund and credit PE fund incentive income is based on realizations.
- (F) A reduction in the fair value of investments could impact our conclusion regarding the potential impairment of our investments or a potential segment basis incentive income reserve for funds which are subject to clawback.
- (G) For GAAP Revenues, hedge fund incentive income would be unchanged as it is not recognized until all contingencies are resolved in the fourth quarter (and Value Recovery Funds do not pay any current incentive income). Incentive income is generally not charged on amounts invested by credit hedge funds in funds managed by external managers.

*Interest Rate Risk*

Fortress Operating Group has debt obligations payable that accrue interest at variable rates. Interest rate changes may therefore impact the amount of interest payments, future earnings and cash flows. Based on debt obligations payable as of June 30, 2010, we estimate that interest expense relating to variable rate debt obligations payable would increase \$3.6 million on an annual basis in the event interest rates were to increase by one percentage point.

*Exchange Rate Risk*

Our investments in Eurocastle and GAGFAH are directly exposed to foreign exchange risk. As of June 30, 2010, we had a \$1.6 million investment in Eurocastle and a \$41.4 million investment in GAGFAH which are accounted for at fair value. In the event of a 10% change in the applicable foreign exchange rate against the U.S. dollar on June 30, 2010, we estimate the gains and losses for the six months ended June 30, 2010 in relation to the value of the shares and options would increase or decrease by \$4.3 million.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. The Company's disclosure controls and procedures are designed to provide reasonable assurance that information is recorded, processed, summarized and reported accurately and on a timely basis. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the

end of such period, the Company's disclosure controls and procedures were effective.

**Changes in Internal Control Over Financial Reporting**

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the most recent fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

---

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We may from time to time be involved in litigation and claims incidental to the conduct of our business. Our industry is always subject to scrutiny by government regulators, which could result in litigation related to regulatory compliance matters. As a result, we maintain insurance policies in amounts and with the coverage and deductibles we believe are adequate, based on the nature and risks of our business, historical experience and industry standards. We believe that the cost of defending any pending or future litigation or challenging any pending or future regulatory compliance matter will not have a material adverse effect on our business. However, increased regulatory scrutiny of hedge fund trading activities combined with extensive trading in our liquid hedge funds may cause us to re-examine our beliefs regarding the likelihood that potential investigation and defense-related costs could have a material adverse effect on our business.

**Item 1A. Risk Factors**

*We face a variety of significant and diverse risks, many of which are inherent in our business. Described below are certain risks that we currently believe could materially affect us. Other risks and uncertainties that we do not presently consider to be material or of which we are not presently aware may become important factors that affect us in the future. The occurrence of any of the risks discussed below could materially and adversely affect our business, prospects, financial condition, results of operations or cash flow.*

***Risks Related to the Financial Services Industry and Financial Markets***

**We do not know what impact the U.S. government's various plans to attempt to stabilize the economy and the financial markets or the increased focus by the government on the regulation of the financial services industry will have on our business.**

Over the past two years, the U.S. government has taken a number of steps to attempt to stabilize the global financial markets and U.S. economy, including direct government investments in, and guarantees of, troubled financial institutions as well as government-sponsored programs such as the TARP.

In addition, on July 21, 2010, the U.S. government enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or "Act"), which imposes significant new regulations on almost every aspect of the U.S. financial services industry, including aspects of our business and the markets in which we operate. Importantly, many key aspects of the changes imposed by the Act will be established by various regulatory bodies and other groups over the next several years. As a result, we do not know exactly what the final regulations under the Act will require or how significantly the Act will affect us. It is possible that the Act could, among other things, increase our costs of operating as a public company and impose restrictions on our business. For additional detail, please see [Our reputation, business and operations could be adversely affected by regulatory compliance failures, the potential adverse effect of changes in laws and regulations applicable to our business and effects of negative publicity surrounding the alternative asset management industry in general.](#)

***Risks Related To Our Business***

**The terms of our credit agreement may restrict our current and future operations, particularly our ability to respond to certain changes or to take future actions.**

Our current credit agreement contains a number of restrictive covenants and requires significant amortization payments over the next several years, which collectively impose significant operating and financial restrictions on us, including restrictions that may limit our ability to engage in acts that may be in our long-term best interests. The terms of our credit agreement impose significant operating and financial restrictions on us. Our current credit agreement includes financial covenants that we:

not exceed a total leverage ratio;

maintain a minimum AUM; and

---

## Table of Contents

maintain a minimum amount of investment assets (and maintain specific amounts of certain types of investments).

The leverage ratio covenant is tested as of the end of each fiscal quarter while the AUM and investment asset covenants are applicable at all times. Our ability to comply with these and other covenants is dependent upon a number of factors, some of which are beyond our control but could nonetheless result in noncompliance. For example, our leverage ratio fluctuates depending upon the amount of cash flow that we generate, and the value of our AUM and investment assets fluctuates due to a variety of factors, including mark-to-market valuations of certain assets and other market factors. The ongoing global economic recession has negatively impacted the cash flow that we have generated and expect to generate in the future as well as the current and expected value of our investment assets and current and expected AUM. These negative conditions, in turn, negatively affect our ability to comply with these covenants. For example, the investment assets on our balance sheet include a limited number of concentrated positions in portfolio companies or other ventures whose liquidity, operating results and financial condition have been adversely affected by the ongoing recession. The failure of a portfolio company to successfully refinance its debt (or a material default by any portfolio company in which we have a material direct or indirect investment) could cause us to lose all, or a significant portion, of the value of our investment attributable to such portfolio company, or any amounts due from the applicable fund, which would, in turn, decrease the amount of our investment assets and could result in our failure to comply with the investment asset covenant in our credit agreement or make compliance more difficult. Our credit agreement also contains other covenants that restrict our operations as well as a number of events that, if they occurred, would constitute an event of default under the agreement.

In addition, our credit agreement requires that we make the following amortization payments during the following time periods: \$14 million during 2010, an additional \$42 million by January 2011, and the remaining balance of \$300 million at the maturity of the facilities in May 2012. Making these payments will require a significant amount of our available cash flow that could otherwise be applied to other purposes such as making investments or paying dividends.

A failure by us to comply with the covenants or amortization requirements or upon the occurrence of other defaults or events of default specified in our credit agreement could result in an event of default under the agreement, which would give the lenders under the agreement the right to terminate their commitments to provide additional loans under our revolving credit facility, to declare all borrowings outstanding, together with accrued and unpaid interest and fees, to be immediately due and payable. In addition, the lenders would have the right to proceed against the collateral we granted to them, which consists of substantially all our assets. If the debt under our credit agreement were to be accelerated, we may not have sufficient cash on hand or be able to sell sufficient collateral to repay this debt, which would have an immediate material adverse affect on our business, results of operations and financial condition. For more detail regarding our credit agreement, its terms and the current status of our compliance with the agreement, please see Part I, Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources and Debt Obligations, and Covenants.

### **We depend on Messrs. Briger, Edens, Kauffman, Nardone and Novogratz, as well as certain other investment professionals, and the loss of any of their services could have a material adverse effect on us.**

The success of our business depends on the efforts, judgment and personal reputations of our principals, Peter Briger, Wesley Edens, Robert Kauffman, Randal Nardone and Michael Novogratz. Our principals' reputations, expertise in investing, relationships with our investors and relationships with members of the business community on whom our funds depend for investment opportunities and financing, are each critical elements in operating and expanding our businesses. We believe our performance is strongly correlated to the performance of these individuals. Accordingly, the retention of our principals is crucial to our success. In addition, if any of our principals were to join or form a competitor, some of our investors could choose to invest with that competitor rather than in our funds. The loss of the services of any of our principals could have a material adverse effect on us, including our ability to retain and attract investors and raise new funds, and the performance of our funds. Two or more of our principals occasionally fly together, which concentrates the potential impact of an accident on our company. We do not carry any key man insurance that would provide us with proceeds in the event of the death or disability of any of our principals.

Each of our principals has entered into an employment agreement with us. The initial term of these agreements ends in February 2012, with automatic one-year renewals until a non-renewal notice is given by us or the principal. If a principal terminates his employment voluntarily or we terminate his employment for cause (as defined in the agreement), the principal will be subject to eighteen-month post-employment covenants requiring him not to compete with us. However, if we terminate a principal's employment without cause, the principal will not be subject to the non-competition provisions.

The principals have also entered into an agreement among themselves, which provides that, in the event a principal voluntarily terminates his employment with us for any reason prior to February 2012, the principal may be required to forfeit a portion of his equity interests in Fortress to the other principals who continue to be employed by Fortress. However, this agreement may be amended by the principals who are then employed by Fortress. We and our shareholders





---

## **Table of Contents**

have no ability to enforce any provision of this agreement or to prevent the principals from amending the agreement or waiving any of its obligations.

There is no guarantee that our principals will not resign, join our competitors or form a competing company, or that the non-competition provisions in the employment agreements would be upheld by a court. If any of these events were to occur, our business, prospects, financial condition and results of operation could be materially adversely affected.

**Several of our funds have key person provisions pursuant to which the failure of one or more of our senior employees to be actively involved in the business provides investors with the right to redeem from the funds or otherwise limits our rights to manage the funds. The loss of the services of any one of such senior employees could have a material adverse effect on certain of our funds to which such key person provisions relate and in some circumstances on us.**

Investors in most of our hedge funds may generally redeem their investment without paying redemption fees if the relevant key person ceases to perform his functions with respect to the fund for 90 consecutive days. In addition, the terms of certain of our hedge funds' financing arrangements contain key person provisions, which may result, under certain circumstances, in the acceleration of such funds' debt or the inability to continue funding certain investments if the relevant employee ceases to perform his functions with respect to the fund and a replacement has not been approved.

The loss or inability of Mr. Novogratz to perform his services for 90 days could result in substantial withdrawal requests from investors in our Global Macro funds and, in the event that a replacement is not approved, the termination of a substantial portion of the funds' financing arrangements. Such withdrawals and terminations would have a material adverse effect on the Global Macro funds by reducing our management fees from those funds. Further, such withdrawals and terminations could lead possibly to the liquidation of the funds and a corresponding elimination of our management fees and potential to earn incentive income from those funds. The loss of Mr. Novogratz could, therefore, ultimately result in a loss of a material portion of our earnings attributable to our liquid hedge fund business segment.

The loss or inability of Mr. Briger to perform his services for 90 days could result in substantial withdrawal requests from investors in our Drawbridge Special Opportunities funds and, in the event that a replacement for him is not approved, the termination of a substantial portion of the funds' financing arrangements. Such withdrawals and terminations would have a material adverse effect on the Drawbridge Special Opportunities funds by reducing our management fees from those funds.

Further, such withdrawals and terminations could lead possibly to the eventual liquidation of the funds and a corresponding elimination of our management fees and potential to earn incentive income from those funds. Similarly, our credit private equity funds contain key man provisions with respect to Mr. Briger, which would limit the ability of the funds to make future investments or call capital if both Mr. Briger and the funds co-chief investment officer, Constantine Dakolias, were to cease to devote time to the funds. The loss of Mr. Briger could, therefore, ultimately result in a loss of a material portion of our earnings attributable to our credit hedge fund and/or credit private equity business segments.

If either Mr. Edens or both of Mr. Kauffman and Mr. Nardone cease to devote certain minimum portions of their business time to the affairs of certain of our private equity funds, the funds will not be permitted to make further investments, and then-existing investments may be liquidated if investors vote to do so. Our ability to earn management fees and realize incentive income from our private equity funds therefore would be adversely affected if we cannot make further investments or if we are required to liquidate fund investments at a time when market conditions result in our obtaining less for investments than could be obtained at later times. In addition, we may be unable to raise additional private equity funds if existing private equity fund key-man provisions are triggered. The loss of either Mr. Edens or both of Mr. Kauffman and Mr. Nardone could, therefore, ultimately result in a loss of substantially all of our earnings attributable to our private equity funds.

Certain of our existing funds have key person provisions relating to senior employees other than the named principals of Fortress, and the resignation or termination of any such senior employee could result in a material adverse effect on the applicable fund or funds. In addition, the terms of certain of our existing funds may be amended over time to add additional key persons, and senior employees (including but not limited to Fortress principals) may also be deemed as key persons for funds that are formed in the future.

Any such events would potentially have a direct material adverse effect on our revenues and earnings (depending on the size of the particular fund to which a key person event relates), and would likely harm our ability to maintain or grow management fee paying assets under management in existing funds or raise additional funds in the future.

**Our ability to retain our managing directors is critical to our success and our ability to grow depends on our ability to attract additional key personnel.**

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

Our success depends on our ability to retain our managing directors and the other members of our investment management team and recruit additional qualified personnel. We collectively refer to these key employees (other than our principals) as

---

**Table of Contents**

our investment professionals. Our investment professionals possess substantial experience and expertise in investing, are responsible for locating and executing our funds' investments, have significant relationships with the institutions which are the source of many of our funds' investment opportunities, and in certain cases have strong relationships with our investors. Therefore, if our investment professionals join competitors or form competing companies it could result in the loss of significant investment opportunities and certain existing investors. As a result, the loss of even a small number of our investment professionals could jeopardize the performance of our funds, which could have a material adverse effect on our results of operations as well as our ability to retain and attract investors and raise new funds. Also, while we have non-competition and non-solicitation agreements with certain investment professionals, there is no guarantee that the agreements to which our investment professionals are subject, together with our other arrangements with them, will prevent them from leaving us, joining our competitors or otherwise competing with us or that these agreements will be enforceable in all cases. In addition, these agreements will expire after a certain period of time, at which point each of our investment professionals would be free to compete against us and solicit investors in our funds, clients and employees.

Efforts to retain or attract investment professionals may result in significant additional expenses, which could adversely affect our profitability, and changes in law could hamper our recruitment and retention efforts. For example, we might not be able, or may elect not, to provide future investment professionals with equity interests in our business to the same extent or with the same tax consequences as our existing investment professionals. Therefore, in order to recruit and retain existing and future investment professionals, we may need to increase the level of cash compensation that we pay to them. Accordingly, as we promote or hire new investment professionals over time, we may increase the level of cash compensation we pay to our investment professionals, which would cause our total employee compensation and benefits expense as a percentage of our total revenue to increase and adversely affect our profitability. In addition, we may deem it necessary to maintain compensation levels to retain employees even during periods when we generate less revenues than in previous periods, which would reduce our profit margins. Also, if proposed legislation were to be enacted by the U.S. Congress to treat carried interest as ordinary income rather than as capital gain for U.S. federal income tax purposes, such legislation would materially increase the amount of taxes that we and our investment professionals that are compensated in part with carried interest would be required to pay on such compensation, thereby adversely affecting our ability to recruit, retain and motivate our current and future professionals. See Our structure involves complex provisions of U.S. federal income tax law for which no clear precedent or authority may be available. Our structure also is subject to potential legislative, judicial or administrative change and differing interpretations, possibly on a retroactive basis. Lastly, issuance of certain equity interests in our business to current or future investment professionals would dilute Class A shareholders.

Certain of our funds face particular retention issues with respect to investment professionals whose compensation is tied, often in large part, to performance thresholds or high water marks. For example, several investment professionals receive performance-based compensation at the end of each year based upon their annual investment performance, and this performance-based compensation has historically represented substantially all of the compensation those professionals are entitled to receive during the year. If the investment professional's annual performance is negative, or insufficient to overcome prior negative results, the professional will not be entitled to receive any performance-based compensation for the year. If the investment professional or fund, as the case may be, does not produce investment results sufficient to merit performance-based compensation, any affected investment professional may be incentivized to join a competitor because doing so would allow the professional to eliminate the burden of having to satisfy the high water mark before earning performance-based compensation. Similarly, many of our investment professionals in our private equity and credit PE fund businesses are compensated with grants of carried interest in our funds. During periods of economic volatility, realization events in our private equity and credit PE fund businesses may be delayed, and it may therefore take significantly longer for investments to result in payments to such professionals. In addition, in the event that overall returns for any of our private equity funds or credit PE funds result in the generation of less incentive income than might have otherwise been anticipated, such professionals' grants of carried interest in such fund will have similarly decreased value. To retain such professionals, the fund's manager may elect to compensate the professional using a portion of the management fees earned by the manager, which would, in turn, reduce the amount of cash available to the public company, thereby reducing the amount available for distribution to our Class A shareholders or other liquidity needs. This retention risk is heightened during periods where market conditions make it more difficult to generate positive investment returns.

**We have experienced rapid growth, which may be difficult to sustain and which may place significant demands on our administrative, operational and financial resources.**

Our rapid growth in recent years has created significant demands on our legal, accounting and operational infrastructure, and increased expenses. The complexity of these demands, and the expense required to address them, is a function not simply of the amount by which our fee paying assets under management have grown, but of significant differences in the investing strategies of our different funds. In addition, we are required to continuously develop our systems and infrastructure in response to the increasing sophistication of the investment management market and legal, accounting and regulatory developments. Moreover, the strains upon our resources caused by our growth are compounded by the additional demands imposed upon us as a public company with shares listed on the New York Stock Exchange and, thus, subject to an extensive body of regulations.



## **Table of Contents**

Our future growth will depend, among other things, on our ability to maintain an operating platform and management system sufficient to address our growth and will require us to incur significant additional expenses and to commit additional senior management and operational resources. As a result, we face significant challenges:

in maintaining adequate accounting, financial, compliance, trading and other business controls,

implementing new or updated information, financial and disclosure systems and procedures, and

in recruiting, training, managing and appropriately sizing our work force and other components of our business on a timely and cost-effective basis.

### **Operational risks may disrupt our businesses, result in losses or limit our growth.**

We face operational risk from errors made in the negotiation, execution, confirmation or settlement of transactions. We also face operational risk from transactions not being properly recorded, evaluated or accounted for in our funds. In particular, our liquid hedge and credit fund businesses are highly dependent on our ability to process and evaluate, on a daily basis, transactions across markets and geographies in a time-sensitive, efficient and accurate manner. Consequently, we rely heavily on our financial, accounting and other data processing systems. In addition, new investment products we introduce create (and recently introduced products created) a significant risk that our existing systems may not be adequate to identify or control the relevant risks in the investment strategies employed by such new investment products. If any of these systems do not operate properly, are inadequately designed or are disabled, we could suffer financial loss, a disruption of our businesses, liability to our funds, regulatory intervention and reputational damage.

In addition, we operate in an industry that is highly dependent on its information systems and technology. We believe that we have designed, purchased and installed high-quality information systems to support our business. There can be no assurance, however, that our information systems and technology will continue to be able to accommodate our operations, or that the cost of maintaining such systems will not increase from its current level. Such a failure to accommodate our operations, or a material increase in costs related to such information systems, could have a material adverse effect on us.

Furthermore, we depend on our headquarters, which is located in New York City, for the operation of our business. A disaster or a disruption in the infrastructure that supports our businesses, including a disruption involving electronic communications or other services used by us or third parties with whom we conduct business, or directly affecting our headquarters, may have an adverse impact on our ability to continue to operate our business without interruption, which could have a material adverse effect on us. Although we have disaster recovery programs in place, there can be no assurance that these will be sufficient to mitigate the harm that may result from such a disaster or disruption. In addition, insurance and other safeguards might only partially reimburse us for our losses.

Finally, we rely on third party service providers for certain aspects of our business, including certain financial operations of our hedge funds. In particular, we rely heavily on the services of third party administrators in our hedge fund businesses, on the general ledger software provider for a number of our funds, and on a third party to provide critical technical support to Logan Circle. Any interruption or deterioration in the performance of these third parties, particularly with respect to the services provided to Logan Circle, could impair the quality of the fund's operations and could impact our reputation and adversely affect our business and limit our ability to grow.

### **Our removal as the investment manager, or the liquidation, of one or more of our funds could have a material negative effect on our business, results of operations and financial condition.**

We derive a substantial portion of our revenues from funds managed pursuant to management agreements that may be terminated or fund partnership agreements that permit investors to request liquidation of investments in our funds on short notice. The termination of certain management agreements or commencement of the dissolution of certain funds would constitute an event of default under our current credit agreement.

The terms of our funds generally give either the general partner of the fund or the fund's board of directors the right to terminate our investment management agreement with the fund. However, insofar as we control the general partner of our funds which are limited partnerships, the risk of termination of investment management agreement for such funds is



## **Table of Contents**

limited, subject to our fiduciary or contractual duties as general partner. This risk is more significant for our offshore hedge funds where we do not serve as the general partner, which represent a significant portion of our hedge fund AUM.

With respect to our private equity funds formed as registered investment companies, each fund's investment management agreement must be approved annually by the independent members of such fund's board of directors and, in certain cases, by its members, as required by law. Termination of these agreements would reduce the fees we earn from the relevant funds.

In addition, investors in any private equity fund or credit PE fund and certain hedge funds have the ability to act, without cause, to accelerate the date on which the fund must be wound down. We will cease earning management fees on the assets of any such fund that is wound down. In addition, the winding down of a material fund or group of funds within a short period of time could trigger an event of default under certain debt covenants in our current credit facility. Our ability to realize incentive income from such funds therefore would be adversely affected if we are required to liquidate fund investments at a time when market conditions result in our obtaining less for investments than could be obtained at later times.

In addition, management agreements of our funds that are registered investment companies under the Investment Company Act of 1940 would terminate if we were to experience a change of control without obtaining investor consent. Such a change of control could be deemed to occur in the event our principals exchange enough of their interests in the Fortress Operating Group into our Class A shares such that our principals no longer own a controlling interest in us. We cannot be certain that consents required for the assignment of our investment management agreements will be obtained if such a deemed change of control occurs. In addition, the boards of directors of certain hedge funds and our Castles have the right under certain circumstances to terminate the investment management agreements or otherwise attempt to renegotiate the terms of such agreements with the applicable fund or Castle. Termination of these agreements, or revisions to the terms that are detrimental to the manager, could affect the fees we earn from the relevant funds, which could have a material adverse effect on our results of operations.

Under the terms of our current credit agreement, if, subject to certain exceptions, we cease to serve as the investment manager of any fund that generates management and incentive fees during the previous twelve months or which we expect to generate such fees within the next twelve months in an aggregate amount of at least \$25 million, such termination would constitute an event of default. In addition, if any such fund commenced a process to dissolve, liquidate or otherwise wind-up the fund outside the ordinary course of business, such commencement would also constitute an event of default under our current credit agreement. If either event of default occurred, it would give our lenders the right to terminate their commitments to lend us funds under our revolving credit facility and to require us to repay all outstanding term loans immediately (in addition to other remedies available under the credit agreement). If our lenders exercised their rights upon the occurrence of an event of default, doing so would likely have an immediate material adverse effect on our business, results of operations and financial condition.

### **We are subject to third-party litigation risk that could result in significant liabilities and reputational harm, which could materially adversely affect our results of operations, financial condition and liquidity.**

In general, we will be exposed to risk of litigation by our fund investors if our management of any fund is alleged to constitute gross negligence or willful misconduct. Investors could sue us to recover amounts lost by our funds due to our alleged misconduct, up to the entire amount of loss. Further, we may be subject to litigation arising from investor dissatisfaction with the performance of our funds or from allegations that we improperly exercised control or influence over companies in which our funds have large investments. By way of example, we, our funds and certain of our employees, are each exposed to the risks of litigation relating to investment activities in our funds and actions taken by the officers and directors (some of whom may be Fortress employees) of portfolio companies, such as risks relating to a portfolio company's mortgage servicing activities and the risk of shareholder litigation by other shareholders of public companies in which our funds have large investments. The stock prices of several of our publicly traded portfolio companies and Castles have decreased significantly relative to their historical high prices (resulting in the delisting of one of our portfolio companies from the NYSE), which decreases may lead to securities class action claims or other suits against us. In our liquid hedge funds, we are exposed to the risk of litigation if the funds suffer catastrophic losses due to the failure of a particular investment strategy or due to the trading activity of an employee who has violated our policies, market rules and regulations. Any litigation arising in such circumstances is likely to be protracted, expensive and surrounded by circumstances which are materially damaging to our reputation and our business.

We are exposed to risks of litigation or investigation relating to transactions that presented conflicts of interest that were not properly addressed. In such actions we could be obligated to bear legal, settlement and other costs (which may be in excess of available insurance coverage). Moreover, although we are typically indemnified by the funds we manage, our rights to indemnification may be challenged. If we are required to incur all or a portion of the costs arising out of litigation or investigations as a result of inadequate insurance proceeds or failure to obtain indemnification from our funds, our results





---

**Table of Contents**

of operations, financial condition and liquidity could be materially adversely affected. In addition, certain of our consolidated subsidiaries act as the general partner of various Fortress Funds and accordingly have potentially unlimited liability for the obligations of the funds under applicable partnership law principles. In the event that any such fund was to fall into a negative net equity position, the full amount of the negative net equity would be recorded as a liability on the balance sheet of the general partner entity. Such liability would be recorded on the Fortress balance sheet in consolidation until the time such liability is legally resolved. While these entities generally have no material assets other than their general partner interests, these entities and Fortress may be subject to litigation in connection with such liabilities if creditors choose to sue to seek repayment of such liabilities. We also face the risk of litigation from investors in our funds, if we do not comply with, or if an investor claims that we have not complied with, restrictions in such funds' organizational documents (for example, restrictions on entering into related party transactions). As a general matter, the litigation environment in the investment management business tends to become worse as a result of extreme market volatility such as the 2008-2009 period. We have experienced negative performance during various periods over the past two years (primarily in the second half of 2008) in several of our investment funds, which increases the likelihood that we will be sued by one or more of our investors.

Our liquid hedge funds, our offshore credit hedge funds and many of our private equity funds and credit PE funds are incorporated or formed under the laws of the Cayman Islands. Cayman Islands laws, particularly with respect to shareholder rights, partner rights and bankruptcy, may differ from the laws of the United States. Cayman Islands laws could change, possibly to the detriment of our funds and investment management subsidiaries. In November 2008, our then flagship liquid hedge funds, the Drawbridge Global Macro Funds, temporarily suspended redemptions from the funds due to the heavy volume of redemption requests received during the fourth quarter of 2008. The suspensions were based, in large part, on the need to renegotiate the terms of various financing arrangements to which one or more of the funds were party. In addition, the Drawbridge Global Macro Funds engaged in a significant restructuring of their business, including the bifurcation of the funds' assets into liquid and illiquid pools, revisions to certain of the fees charged to the funds' investors, payment of redemption proceeds in a combination of cash and in-kind distributions in the form of interests in an entity that holds interests in the illiquid pool and allowing non-redeeming investors to exchange their interests in the liquid pool of assets into a newly-formed fund. Since the time of such transactions, the Drawbridge Global Macro Funds have successfully renegotiated the terms of their financing arrangements, lifted the suspension of redemptions and paid cash redemptions for a substantial portion of the redeemed investments, and have also launched the new fund (Fortress Macro Fund) as of May 1, 2009.

Also, as a public company, we are subject to the risk of investigation or litigation by regulators or our public shareholders arising from an array of possible claims, including investor dissatisfaction with the performance of our businesses or our share price, allegations of misconduct by our officers and directors or claims that we have inappropriately dealt with conflicts of interest or investment allocations. It is also likely that the public company would be brought into any lawsuit that is filed involving any of the fund-related litigation and regulatory risks described above. As with the funds, while the public company maintains insurance, there can be no assurance that its insurance will prove to be adequate. If the public company is required to incur all or a portion of the costs arising out of litigation or investigations, our results of operations could be materially adversely affected. Furthermore, any such litigation or investigation could be protracted, expensive and highly damaging to the public company's reputation, even if the underlying claims are without merit. In addition, we may participate in transactions that involve litigation (including the enforcement of property rights) from time to time, and such transactions may expose us to reputational risk and increased risk from countersuits.

In addition, with a workforce consisting of many very highly paid investment professionals, we face the risk of lawsuits relating to claims for compensation, which may individually or in the aggregate be significant in amount. Such claims are more likely to occur in the current environment where individual employees may experience significant volatility in their year-to-year compensation due to trading performance or other issues and in situations where previously highly compensated employees were terminated for performance or efficiency reasons, as has occurred over the past year in a number of instances. The cost of settling such claims could adversely affect our results of operations.

**Our reputation, business and operations could be adversely affected by regulatory compliance failures, the potential adverse effect of changes in laws and regulations applicable to our business and effects of negative publicity surrounding the alternative asset management industry in general.**

Potential regulatory action poses a significant risk to our reputation and thereby to our business. Our business is subject to extensive regulation in the United States and in the other countries in which our investment activities occur. The Securities and Exchange Commission, or SEC, oversees our activities as a registered investment adviser under the Investment Advisers Act of 1940. In addition, we are subject to regulation under the Investment Company Act of 1940, the Securities Exchange Act of 1934, and various other statutes. We are subject to regulation by the Department of Labor under the Employee Retirement Income Security Act of 1974 or ERISA. We and our Castles, as public companies, are subject to applicable stock exchange regulations, and both we and Newcastle are subject to the Sarbanes-Oxley Act of 2002. A number of portfolio companies in our private equity funds are also publicly traded and/or are subject to significant



## **Table of Contents**

regulatory oversight from non-financial bodies (such as our senior living and railroad investments). A number of our investing activities, such as our lending business, are subject to regulation by various U.S. state regulators. In the United Kingdom, we are subject to regulation by the U.K. Financial Services Authority. Our other European operations, and our investment activities around the globe, are subject to a variety of regulatory regimes that vary country by country.

Each of the regulatory bodies with jurisdiction over us has regulatory powers dealing with many aspects of financial services, including the authority to grant, and in specific circumstances to cancel, permissions to carry on particular businesses. A failure to comply with the obligations imposed by the Investment Advisers Act of 1940 on investment advisers, including record-keeping, advertising and operating requirements, disclosure obligations and prohibitions on fraudulent activities, or by the Investment Company Act of 1940, could result in investigations, sanctions and reputational damage. Our liquid hedge fund business, and, to a lesser degree, our credit fund business, are involved regularly in trading activities which implicate a broad number of U.S. and foreign securities law regimes, including laws governing trading on inside information, market manipulation and a broad number of technical trading requirements that implicate fundamental market regulation policies. Violation of such laws could result in severe restrictions on our activities and in damage to our reputation.

Some of our private equity funds currently qualify as venture capital operating companies, or VCOC, and therefore are not subject to the fiduciary requirements of ERISA with respect to their assets. However, it is possible that the U.S. Department of Labor may amend the relevant regulations or the characteristics of our funds may change. If these funds fail to qualify as VCOCs or otherwise satisfy the requirements of ERISA, including the requirement of investment prudence and diversification or the prohibited transaction rules, it could materially interfere with our activities in relation to these funds or expose us to risks related to our failure to comply with such requirements.

Our failure to comply with applicable laws or regulations could result in fines, censure, suspensions of personnel or investing activities or other sanctions, including revocation of our registration as an investment adviser. The regulations to which our businesses are subject are designed primarily to protect investors in our funds and to ensure the integrity of the financial markets. They are not designed to protect holders of our publicly traded Class A shares. Even if a sanction imposed against us or our personnel by a regulator is for a small monetary amount, the adverse publicity related to such sanction against us by regulators could harm our reputation, result in redemptions by investors from our funds and impede our ability to raise additional capital or new funds.

As a result of recent highly-publicized financial scandals as well as the ongoing financial turmoil and government bailout measures, investors, regulators and the general public have exhibited concerns over the integrity of both the U.S. financial markets and the regulatory oversight of these markets. As a result, the regulatory environment in which we operate is subject to heightened scrutiny. With respect to alternative asset management funds, in recent years, there has been debate in both the U.S. and foreign governments about new rules or regulations to be applicable to hedge funds or other alternative investment products. Moreover, as calls for additional regulation have increased, there may be a related increase in regulatory investigations of the trading and other investment activities of alternative asset management funds, including our funds. Such investigations may impose additional expenses on us, may require the attention of senior management and may result in fines if any of our funds are deemed to have violated any regulations.

The United States recently enacted the Dodd-Frank Act, which imposes significant new regulations on almost every aspect of the U.S. financial services industry, including aspects of our business and the markets in which we operate. The Act imposes a wide array of regulations covering, among other things: oversight and regulation of systemic market risk (including the power to liquidate certain institutions); authorizes the Federal Reserve to regulate non-bank institutions; generally prohibits insured depository institutions and their affiliates from conducting proprietary trading and investing in private equity funds and hedge funds; imposes new registration, recordkeeping and reporting on private fund investment advisers; generally requires OTC derivatives to be cleared through an exchange; imposes minimum equity retention requirements for issuers of asset-backed securities; establishes a new bureau of consumer financial protection, establishes new requirements and higher liability standards on credit rating agencies; requires increased disclosure of executive compensation and provides shareholders with the right to vote on executive compensation. Importantly, many key aspects of the changes imposed by the Act will be established by various regulatory bodies and other groups over the next several years. As a result, we do not know what the final regulations under the Act will require or how significantly the Act will affect us. The Act will likely increase our administrative costs and could impose additional restrictions on our business.

## **Table of Contents**

Our results of operations may also be negatively impacted if certain proposed tax legislation is enacted. If legislation were to be enacted by the U.S. Congress to treat carried interest as ordinary income rather than as capital gain for U.S. federal income tax purposes, such legislation would materially increase the amount of taxes that we and possibly our equityholders are required to pay, thereby reducing the value of our Class A shares and adversely affecting our ability to recruit, retain and motivate our current and future professionals. President Obama has publicly stated that he supports similar changes to the tax code. See Our structure involves complex provisions of U.S. federal income tax law for which no clear precedent or authority may be available. Our structure also is subject to potential legislative, judicial or administrative change and differing interpretations, possibly on a retroactive basis and Legislation has been introduced that would, if enacted, preclude us from qualifying for treatment as a partnership for U.S. federal income tax purposes under the publicly traded partnership rules. Our structure also is subject to potential judicial or administrative change and differing interpretations, possibly on a retroactive basis. Any such changes could increase our costs of doing business or materially adversely affect our profitability.

### **Foreign regulators have proposed legislation that would potentially impose a number of other new regulatory requirements, which would increase our costs and could make it more difficult to operate and market our funds.**

European regulators have proposed legislation that would require funds (including both private equity funds and hedge funds) to satisfy various criteria as a precondition to allowing Europeans to invest in such funds. For example, the proposed legislation would establish criteria for foreign jurisdictions to satisfy in order for funds domiciled in those jurisdictions to take investments from European citizens. The criteria could address topics such as money laundering, terrorism financing, information sharing, tax agreements and depository access. It is currently not clear whether the Cayman Islands, where a significant number of our funds are domiciled, will be deemed to be an acceptable jurisdiction under the proposed legislation. If the legislation is enacted as proposed, and any of our funds are domiciled in jurisdictions that are not approved under the legislative criteria, then those funds would not be permitted to take investments from European citizens. In addition to the jurisdictional criteria, the proposed legislation would require non-European Union fund managers (which would likely include Fortress) to pledge to follow various new rules covering topics such as reporting and custody requirements and limitations on incurring leverage. If adopted in the form proposed, this legislation would impose significant new regulatory requirements on investment managers operating within the EU, including with respect to conduct of business, compensation of employees, regulatory capital, valuations, disclosures and marketing. Such rules could potentially impose significant additional costs on the operation of our business in the EU and could limit our operating flexibility within that jurisdiction. In addition, if our funds are domiciled in jurisdictions that do not satisfy the EU's requirements, the legislation will prevent those funds from taking on European investors, which could limit the size of such funds and restrict our ability to grow our business.

### **Our failure to deal appropriately with conflicts of interest could damage our reputation and adversely affect our business.**

As we have expanded the number and scope of our businesses, we increasingly confront potential conflicts of interest relating to our funds investment activities. Certain of our funds have overlapping investment objectives, including funds

---

## **Table of Contents**

which have different fee structures, and potential conflicts may arise with respect to our decisions regarding how to allocate investment opportunities among those funds. For example, a decision to acquire material non-public information about a company while pursuing an investment opportunity for a particular fund gives rise to a potential conflict of interest when it results in our having to restrict the ability of other funds to take any action. In addition, holders of Class A shares may perceive conflicts of interest regarding investment decisions for funds in which our principals, who have and may continue to make significant personal investments in a variety of Fortress Funds, are personally invested. Similarly, conflicts of interest may exist or develop regarding decisions about the allocation of specific investment opportunities between Fortress and the Fortress Funds or in situations where multiple funds are making investments in one portfolio company at the same or different levels of the investee's capital structure. Moreover, because certain of our operating entities are held, in part, by FIG Corp., which is subject to U.S. federal corporate income tax, conflicts of interest may exist regarding decisions about which of Fortress's holdings should be held by these taxable entities and which by entities not subject to U.S. federal corporate income tax. We have historically, from time to time made advances or loans to, or acquired preferred equity interests in, various of our investment funds. In addition, our principals have sometimes extended similar capital to our funds, or made equity investments in portfolio companies, in their individual capacities. The existence and the repayment of such obligations by the funds to us and our principals, or the existence of our principals having personal investments in our portfolio companies, creates the potential for claims of conflicts of interest by our fund and portfolio company investors.

Pursuant to the terms of our operating agreement, whenever a potential conflict of interest exists or arises between any of the principals, one or more directors or their respective affiliates, on the one hand, and the company, any subsidiary of the company or any member other than a principal, on the other, any resolution or course of action by our board of directors shall be permitted and deemed approved by all shareholders if the resolution or course of action (i) has been specifically approved by a majority of the members of a committee composed entirely of two or more independent directors, or it is deemed approved because it complies with rules or guidelines established by such committee, (ii) has been approved by a majority of the total votes that may be cast in the election of directors that are held by disinterested parties, (iii) is on terms no less favorable to the company or shareholders (other than a principal) than those generally being provided to or available from unrelated third parties or (iv) is fair and reasonable to the company taking into account the totality of the relationships between the parties involved. Notwithstanding the foregoing, it is possible that potential or perceived conflicts could give rise to investor dissatisfaction or litigation or regulatory enforcement actions. Appropriately dealing with conflicts of interest is complex and difficult and our reputation could be damaged if we fail, or appear to fail, to deal appropriately with one or more potential or actual conflicts of interest. Regulatory scrutiny of, or litigation in connection with, conflicts of interest would have a material adverse effect on our reputation, which would materially adversely affect our business in a number of ways, including as a result of redemptions by our investors from our hedge funds, an inability to raise additional funds and a reluctance of counterparties to do business with us.

### **Employee misconduct could harm us by impairing our ability to attract and retain investors and by subjecting us to significant legal liability, regulatory scrutiny and reputational harm.**

Our reputation is critical to maintaining and developing relationships with the investors in our funds, potential investors and third-parties with whom we do business. In recent years, there have been a number of highly-publicized cases involving fraud, conflicts of interest or other misconduct by individuals in the financial services industry in general and the hedge fund industry in particular. There is a risk that our employees could engage in misconduct that adversely affects our business. For example, if an employee were to engage or be accused of engaging in illegal or suspicious activities (such as improper trading, disclosure of confidential information or breach of fiduciary duties), we could be subject to regulatory sanctions and suffer serious harm to our reputation, financial position, investor relationships and ability to attract future investors. Employee misconduct could prompt regulators to allege or to determine based upon such misconduct that we have not established adequate supervisory systems and procedures to inform employees of applicable rules or to detect and deter violations of such rules. It is not always possible to deter employee misconduct, and the precautions we take to detect and prevent this activity may not be effective in all cases. Misconduct by our employees, or even unsubstantiated allegations, could result in a material adverse effect on our reputation and our business.

### **The alternate investment management business is intensely competitive, and the industry is in a state of flux.**

Due to the global economic recession, the general state of distress in the financial markets and the generally weaker returns in the alternative asset management business over the last two years, the alternative asset management industry is generally perceived to be in a state of transition. The industry has been marked over this period by increasing anxiety on the part of institutional fund investors as those investors have suffered from decreasing returns, liquidity pressure, significant volatility and difficulty maintaining targeted asset allocations, and a significant number of investors have materially decreased or temporarily stopped making new fund investments during this period. Market commentators and analysts have expressed the belief that as the economy begins to recover and such investors begin to increase the pace of new investments, those investors are likely to concentrate their holdings in a smaller overall group of managers that have relatively long-term track records, and that such factors are likely to result in a period of significant industry consolidation, especially in the hedge fund sector. In addition, it is possible that such investors may elect to reduce their overall portfolio allocations to alternative investments such as private equity and hedge funds, resulting in a smaller overall pool of available capital in our sector.



**Table of Contents**

In the event all or part of this analysis proves true, when trying to raise new capital the Company will be competing for fewer total available assets in an increasingly competitive environment, and there can be no assurance that we will be successful in continuing to raise capital at our historical growth rates. Depending on industry dynamics, we and our competitors may be compelled to offer investors improved terms (such as lower fees, improved liquidity or increased principal investments in funds) in order to continue to attract significant amounts of fresh investment capital. Such changes would adversely affect our revenues and profitability. As has historically been the case, competition in our industry is based on a number of factors, including:

investment performance;

investors' liquidity and willingness to invest;

investor perception of investment managers' drive, focus and alignment of interest;

changing, often attenuated decision making processes used by investors;

actual or perceived financial condition, liquidity and stability of the Company;

quality of service provided to and duration of relationship with investors;

business reputation; and

level of fees and expenses charged for services.

We compete in all aspects of our business with a large number of investment management firms, private equity fund sponsors, hedge fund sponsors and other financial institutions. A number of factors serve to increase our competitive risks:

investors may develop concerns that we will allow a business to grow to the detriment of its performance;

investors may reduce their investments with us or not make additional investments with us based upon our recent investment performance, current market conditions, their available capital or their perception of the health of our business;

some of our competitors have greater capital, a lower cost of capital, better access to financing, lower targeted returns or greater sector or investment strategy specific expertise than we do, which creates competitive disadvantages with respect to investment opportunities;

some of our competitors may have greater technical, marketing and other resources than we possess;



## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

some of our competitors may perceive risk differently than we do, which could allow them either to outbid us for investments in particular sectors or, generally, to consider a wider variety of investments;

some of our funds may not perform as well as competitor funds or other available investment products;

our competitors that are corporate buyers may be able to achieve synergistic cost savings in respect of an investment, which may provide them with a competitive advantage in bidding for an investment, particularly if conditions in the debt markets increase our financing costs or make debt financing generally unavailable or cost prohibitive;

some investors may prefer to invest with an investment manager that is not publicly traded; and

other industry participants continuously seek to recruit our investment professionals, particularly our best and brightest, away from us.

These and other factors could reduce our earnings and revenues and materially adversely affect our business. In addition, if we are forced to compete with other alternative asset managers on the basis of price, we may not be able to maintain our current management and performance fee structures. We have historically competed primarily on the performance of our funds, and not on the level of our fees relative to those of our competitors.

**The due diligence process that we undertake in connection with investments by our investment funds or the public company may not reveal all facts that may be relevant in connection with an investment.**

Before making investments, we conduct due diligence that we deem reasonable and appropriate based on the facts and circumstances applicable to each investment. When conducting due diligence, we may be required to evaluate important and complex business, financial, tax, accounting, environmental and legal issues. Outside consultants, legal advisors, accountants and investment banks may be involved in the due diligence process in varying degrees depending on the type of investment. Nevertheless, when conducting due diligence and making an assessment regarding an investment, we rely on the resources available to us, including information provided by the target of the investment and, in some circumstances, third-party investigations. In addition, if investment opportunities are scarce or the process for selecting bidders is competitive, our ability to conduct a due diligence investigation may be limited, and we would be required to make investment decisions based upon imperfect information. The due diligence investigation that we will carry out with respect to any investment opportunity may not reveal or highlight all relevant facts that may be necessary or helpful in evaluating such investment opportunity, including, among other things, the existence of fraud or other illegal or improper behavior. Moreover, such an investigation will not necessarily result in the investment being successful.

---

**Table of Contents****Failure to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act could have a material adverse effect on our business and stock price.**

As a public company, we are required to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002. While management has certified that our internal controls over financial reporting were effective as of December 31, 2009 and 2008, because internal control over financial reporting is complex and may be revised over time to adapt to changes in our business, or changes in applicable accounting rules, we cannot assure you that our internal control over financial reporting will be effective in the future. For example, the FASB recently proposed changes to the rules for consolidating entities in financial statements, which, if enacted with respect to our funds, would require us to consolidate entities that we do not currently consolidate, and, therefore, to document and test effective internal controls over the financial reporting of these entities in accordance with Section 404, which we may be unable to do. If we are not able to maintain effective internal control over financial reporting, our independent registered public accounting firm may not be able to certify as to the effectiveness of our internal control over financial reporting as of the required dates. Matters impacting our internal controls may cause us to be unable to report our financial information on a timely basis and thereby subject us to adverse regulatory consequences, including sanctions or investigations by the SEC, or violations of applicable stock exchange listing rules, and result in a breach of the covenants under our credit agreement. There could also be a negative reaction in the financial markets due to a loss of investor confidence in us and the reliability of our financial statements. Confidence in the reliability of our financial statements is also likely to suffer if we or our independent registered public accounting firm reports a material weakness in our internal control over financial reporting. This could materially adversely affect us and lead to a decline in our share price and impair our ability to raise capital.

**Our organizational documents do not limit our ability to enter into new lines of businesses, and we may enter into new businesses, make future strategic investments or acquisitions or enter into joint ventures, each of which may result in additional risks and uncertainties in our business.**

We intend, to the extent that market conditions warrant, to grow our business by increasing management fee paying assets under management in existing businesses and creating new investment products. Our organizational documents, however, do not limit us to the investment management business. Accordingly, we may pursue growth through strategic investments, acquisitions or joint ventures, which may include entering into new lines of business, such as the banking, insurance, broker-dealer or financial advisory industries, and which may involve assuming responsibility for the actual operation of assets or entire companies. In addition, we expect opportunities will arise to acquire other alternative or traditional asset managers, such as Logan Circle Partners. To the extent we make strategic investments or acquisitions, enter into joint ventures, or enter into a new line of business, we will face numerous risks and uncertainties, including risks associated with (i) the required investment of capital and other resources, (ii) the possibility that we have insufficient expertise to engage in such activities profitably or without incurring inappropriate amounts of risk, and (iii) combining or integrating operational and management systems and controls. Entry into certain lines of business may subject us to new laws and regulations with which we are not familiar, or from which we are currently exempt, and may lead to increased litigation and regulatory risk and negative publicity. For example, we recently acquired Logan Circle Partners, which is a traditional asset manager that is required to comply with ERISA regulations from which our other funds are currently exempt. If a new business generates insufficient revenues or if we are unable to efficiently manage our expanded operations, our results of operations will be adversely affected. In the case of joint ventures, we are subject to additional risks and uncertainties in that we may be dependent upon, and subject to liability, losses or reputational damage relating to, systems, controls and personnel that are not under our control.

**Our revenue and profitability fluctuate, particularly inasmuch as we cannot predict the timing of realization events in our private equity and credit PE businesses, which may make it difficult for us to achieve steady earnings growth on a quarterly basis and may cause volatility in the price of our Class A shares.**

We experience significant variations in revenues and profitability during the year and among years because, among other reasons, we are paid incentive income from certain funds only when investments are realized, rather than periodically on the basis of increases in the funds' net asset values. The timing and receipt of incentive income generated by our private equity funds and credit PE funds is event driven and thus highly variable, which contributes to the volatility of our segment revenue, and our ability to realize incentive income from our private equity funds and credit PE funds may be limited. It takes a substantial period of time to identify attractive investment opportunities, to raise all the funds needed to make an investment and then to realize the cash value (or other proceeds) of an investment through a sale, public offering, recapitalization or other exit. Even if an investment proves to be profitable, it may be several years before any profits can be realized. We cannot predict when, or if, any realization of investments will occur, and the current challenging conditions in the financing markets have made it more difficult for potential buyers to finance purchases with third-party funds on favorable terms, thereby reducing the likelihood of investment realizations at favorable prices in the near term. If we were

**Table of Contents**

to have a realization event in a particular quarter, it may have a significant impact on our segment revenues and profits for that particular quarter which may not be replicated in subsequent quarters. In addition, our private equity fund and credit PE fund investments are adjusted for accounting purposes to their net asset value at the end of each quarter, resulting in revenue (loss) attributable to our principal investments, even though we receive no cash distributions from our private equity funds and credit PE funds, which could increase the volatility of our quarterly earnings. The terms of the operating documents of our private equity funds and credit PE funds generally require that if any investment in a particular fund has been marked down below its initial cost basis, the aggregate amount of any such markdowns (plus the amount of the accrued preferred return on the capital used to make such investments) be factored into the computation of the amount of any incentive income we would otherwise collect on the realization of other investments within the same fund. This provision generally will result in an overall lower level of incentive income being collected by the Company in the near term for any private equity fund or credit PE fund that has investments that are carried both above and below their cost basis. To the extent that our principal investments in our private equity funds or credit PE funds (or direct investments in private equity transactions) are marked down, such mark downs will flow through our statements of operations as a GAAP loss, even in circumstances where we have a long investment horizon and have no present intention of selling the investment.

With respect to our hedge funds, our incentive income is paid annually if the net asset value of a fund has increased for the period. The amount (if any) of the incentive income we earn from our hedge funds depends on the increase in the net asset value of the funds, which is subject to market volatility. Our liquid hedge funds have historically experienced significant fluctuations in net asset value from month to month. Certain of our hedge funds also have high water marks whereby we do not earn incentive income for a particular period even though the fund had positive returns in such period if the fund had greater losses in prior periods. Therefore, if a hedge fund experiences losses in a period, we will likely not be able to earn incentive income from that fund until it surpasses the previous high water mark.

As of June 30, 2010, the investment performance of our former flagship liquid hedge fund is down from the date on which such fund last earned incentive income. Each fund must generate earnings, on an investor by investor basis, equal to the amount lost as a result of negative performance before it will generate additional incentive income for Fortress from existing fund investors. See Note 2 to the consolidated financial statements included herein for more information.

In addition, no private equity fund or credit PE fund will earn incentive income on any particular investment in the event that the aggregate carrying value of the other investments contained in the same fund is lower than the invested and unreturned capital in such fund plus, in some cases, any preferred return relating to such fund. The net asset values of some of these funds, as of June 30, 2010, were below these amounts as they apply to the respective funds and, thus, these funds will not be able to earn incentive income until their respective net asset values exceed these amounts. The aggregate amount by which these amounts for all such private equity funds exceeded the funds' respective net asset values as of June 30, 2010 was approximately \$9.4 billion.

These quarterly fluctuations in our revenues and profits in any of our businesses could lead to significant volatility in the price of our Class A shares.

**An increase in our borrowing costs may adversely affect our earnings and liquidity.**

Under our current credit agreement, we have a \$75 million revolving credit facility and a \$355.9 million term loan facility. As of June 30, 2010, we had a \$355.9 million term loan outstanding and nothing outstanding under our revolving credit facility (\$8.1 million of letters of credit were outstanding under a letter of credit subfacility). One of the lenders under this facility, representing approximately \$7.2 million of outstanding commitments, has filed for bankruptcy protection and thus is unlikely to fulfill any borrowing requests. Borrowings under the credit agreement mature on May 10, 2012. As our facilities mature, we will be required to either refinance them by entering into new facilities or issuing new debt, which could result in higher borrowing costs, or issuing equity, which would dilute existing shareholders. We could also repay them by using cash on hand (if available) or cash from the sale of our assets. No assurance can be given that we will be able to enter into new facilities, issue new debt or issue equity in the future on attractive terms, or at all.

Our credit facility loans are typically LIBOR-based floating-rate obligations and the interest expense we incur will vary with changes in the applicable LIBOR reference rate. As a result, an increase in short-term interest rates will increase our interest costs and will reduce the spread between the returns on our investments and the cost of our borrowings. An increase in interest rates would adversely affect the market value of any fixed-rate debt investments and/or subject them to prepayment or extension risk, which may adversely affect our earnings and liquidity.

---

## **Table of Contents**

### **We have previously participated in large-sized investments, which involve certain complexities and risks that are not encountered in small- and medium-sized investments.**

Our private equity funds have previously participated in several large transactions. The increased size of these investments involves certain complexities and risks that may not be encountered in small- and medium-sized investments. For example, larger transactions may be more difficult to finance and complete, and exiting larger deals may present challenges in many cases. In addition, larger transactions may entail greater scrutiny by regulators, labor unions, political bodies and other third parties and greater risk of litigation. Recently, labor unions and members of Congress have been more active in opposing and investigating certain larger investments by private equity firms generally.

Larger transactions may be structured as consortium transactions due to the size of the investment and the amount of capital required to be invested. A consortium transaction involves an equity investment in which two or more private equity firms serve together or collectively as equity sponsors. We may participate in a meaningful number of consortium transactions in the future. Consortium transactions generally entail a reduced level of control by Fortress over the investment because governance rights must be shared with the other private equity investors. Accordingly, we may not be able to control decisions relating to the investment, including decisions relating to the management and operation of the company and the timing and nature of any exit, which could result in the risks described in [Our investment funds make investments in companies that we do not control](#).

Any of these factors could increase the risk that our larger investments could be unsuccessful. The consequences to our investment funds of an unsuccessful larger investment could be more severe than a small investment given the size of the investment.

### **Our investment funds often make investments in companies that we do not control.**

Investments by most of our investment funds will include debt instruments and equity securities of companies that we do not control. Such instruments and securities may be acquired by our investment funds through trading activities or through purchases of securities from the issuer. In addition, our private equity funds and credit PE funds may acquire debt investments or minority equity interests (particularly in consortium transactions, as described in [We have recently participated in large-sized investments, which involve certain complexities and risks that are not encountered in small- and medium-sized investments](#) ) and may also dispose of a portion of their majority equity investments in portfolio companies over time in a manner that results in the investment funds retaining a minority investment. Those investments will be subject to the risk that the company in which the investment is made may make business, financial or management decisions with which we do not agree or that the majority stakeholders or the management of the company may take risks or otherwise act in a manner that does not serve our interests. If any of the foregoing were to occur, the values of investments by our investment funds could decrease and our financial condition, results of operations and cash flow could suffer as a result.

### ***Risks Related to Our Funds***

Our results of operations are dependent on the performance of our funds. Poor fund performance will result in reduced revenues, reduced returns on our principal investments in the funds and reduced earnings. Poor performance of our funds will also make it difficult for us to retain or attract investors to our funds and to grow our business. The performance of each fund we manage is subject to some or all of the following risks.

### **The historical performance of our funds should not be considered as indicative of the future results of our funds or of our future results or of any returns expected on our Class A shares.**

The historical and potential future returns of the funds we manage are not directly linked to returns on our Class A shares. Therefore, readers should not conclude that positive performance of the funds we manage will necessarily result in positive returns on our Class A shares. However, poor performance of the funds we manage will cause a decline in our revenue from such funds, and will therefore have a negative effect on our performance and the returns on our Class A shares.

Moreover, with respect to the historical performance of our funds:

the historical performance of our funds should not be considered indicative of the future results that should be expected from such funds or from any future funds we may raise, in part because the market conditions during previous periods were significantly more favorable for generating positive performance, particularly in our private equity business, than the market conditions we have experienced for the last two years and may continue to experience for the foreseeable future;

the performance of a number of our funds which is calculated on the basis of net asset value of the funds' investments, reflects unrealized gains that may never be realized;

our funds' returns have benefited from investment opportunities and general market conditions that currently do not exist and may not repeat themselves, and there can be no assurance that our current or future funds will be able to avail themselves of profitable investment opportunities; and

**Table of Contents**

several of our private equity portfolio companies have become public companies and have experienced significant subsequent decreases in their public market value. There can be no assurance that we will be able to realize such investments at profitable sale prices, particularly if market conditions are weak or the market perceives that the companies will perform less well when Fortress reduces its investment in them.

**Poor performance of our funds will cause a decline in our revenue and results of operations, may obligate us to repay incentive income previously paid to us, and could adversely affect our ability to raise capital for future funds.**

Our revenue from the Fortress Funds is derived principally from three sources: (1) management fees, based on the size of our funds; (2) incentive income, based on the performance of our funds; and (3) investment income (loss) from our investments in the funds, which we refer to as our principal investments. Our investors and potential investors continually assess our funds' performance and our ability to raise capital. In the event that any of our funds perform poorly or suffer from liquidity constraints due to operational or market forces, our funds may be unable to pay all or part of the management fees that we are owed for an indeterminate period of time or may require advances to cover expenses which would negatively impact our revenues, liquidity and results of operations and potentially make it more difficult for us to raise new capital. In situations where we have deferred the receipt of management or other fees in order to provide liquidity to one or more of our managed funds, amounts that we have advanced to those funds may be difficult to collect in the future (or may take longer than anticipated to collect) if such funds have continued liquidity problems or if fund investors raise objections to such collections. As of June 30, 2010, the aggregate amount of management fees that various of our managed funds currently owe but have not yet paid was approximately \$49.7 million, of which \$11.3 million has been subordinated to other liabilities of the related fund and has been fully reserved by us, and the aggregate amount of advances made by the public company to various of our managed funds to cover expenses was approximately \$10.7 million. In addition, hedge fund investors may redeem their investments in our funds, while investors in private equity funds and credit PE funds may decline to invest in future funds we raise, as a result of poor performance of our funds or otherwise. Our liquid hedge funds received redemption requests, including affiliates, for a total of \$0.4 billion during the six months ended June 30, 2010 and \$2.2 billion and \$5.5 billion during the years ended December 31, 2009 and 2008, respectively, and our credit hedge funds received return of capital requests, including affiliates, for \$0.3 billion during the six months ended June 30, 2010 and for \$1.5 billion and \$1.5 billion during the years ended December 31, 2009 and 2008, respectively. The return of capital notice dates for our flagship credit hedge fund and for our Fortress Partners Fund had not yet occurred as of June 30, 2010. Losses in our funds also directly impact our operating performance by decreasing the size of our assets under management, which results in lower management fee revenues. Furthermore, if, as a result of poor performance of investments in a private equity fund's or credit PE fund's life, the fund does not achieve total investment returns that exceed a specified investment return threshold the life of the fund, we will be obligated to repay the amount by which incentive income that was previously distributed to us exceeds the amounts to which we are ultimately entitled. We have contractually agreed to guarantee the payment in certain circumstances of such clawback obligations for our managed investment funds that are structured as private equity funds and credit PE funds. If all of our existing private equity funds and credit PE funds were liquidated at their NAV as of June 30, 2010, the cumulative clawback obligation to investors in these funds would be approximately \$62.0 million (net of amounts that would be due back from employees pursuant to profit sharing arrangements, and without regard to potential tax adjustments).

In addition, we may be unable as a result of poor performance of previous funds or other issues to raise enough new capital and new funds to seize investment opportunities in the future. If our competitors are more successful than we are in raising new fund capital and seizing investment opportunities, we may face challenges in competing for future investor capital and investment opportunities.

**Difficult market conditions can adversely affect our funds in many ways, including by reducing the value or performance of the investments made by our funds and reducing the ability of our funds to raise or deploy capital, which could materially reduce our revenue and adversely affect results of operations.**

If economic and market conditions continue to be challenging, our funds may not perform well, and we may not be able to raise money in existing or new funds. Our funds are materially affected by conditions in the global financial markets and economic conditions throughout the world. The global market and economic climate have deteriorated and in the future may further deteriorate because of many factors beyond our control, including rising interest rates or accelerating asset deflation or inflation, further deterioration in the credit and finance markets, deterioration in the credit of sovereign nations, terrorism or political uncertainty. In the event of a continued market downturn, each of our businesses could be affected in different ways. Our private equity funds have faced reduced opportunities to sell and realize value from their existing investments, a frequent scarcity of attractive financing, the need to invest additional capital into existing investments or to satisfy the terms of financing agreements and a lack of suitable investments for the funds to make. In addition, adverse market or economic conditions as well as the slowdown of activities in particular sectors in which portfolio companies of these funds operate (including travel, leisure, real estate, gaming and senior living) have had an adverse effect on the earnings and liquidity of such portfolio companies, which in some cases has negatively impacted the valuations of our funds' investments and, therefore, our actual and potential earnings from management and incentive fees. A significant



## Table of Contents

number of our portfolio companies in our private equity funds have material indebtedness which needs to be periodically paid down or refinanced (including some which have maturity dates within the next 12 months) and some of which contains financial covenants. If the credit markets continue to experience material stress for a prolonged period, such companies may have difficulty refinancing such indebtedness or may breach financial or operating covenants in their credit agreements, which could result in an event of default or bankruptcy at the portfolio company level. Such events would result in a material diminution in value of our funds' investment in such company and would likely have a reputational impact on us as an investment manager. In some cases our private equity funds have guaranteed debt of their portfolio companies, and if such guarantees are called upon in the event that the applicable portfolio company defaults on its debt, payment of amounts due under the guarantee could have a material negative impact on the fund's financial condition.

The challenging market conditions that we have been experiencing has adversely affected our operating performance in a number of ways, and if the downturn continues, it may cause our revenue, results of operations and financial condition to further decline by causing:

AUM to decrease, lowering management fees;

increases in costs of financial instruments;

adverse conditions for our portfolio companies (e.g., decreased revenues, liquidity pressures, increased difficulty in obtaining access to financing and complying with the terms of existing financings as well as increased financing costs);

lower investment returns, reducing incentive income or eliminating incentive income for a period of time;

reduced demand to purchase assets held by our funds, which would negatively affect the funds' ability to realize value from such assets;

material reductions in the value of our private equity fund investments in portfolio companies which reduce our ability to realize incentive income from these investments;

difficulty raising additional capital;

investor redemptions, resulting in lower fees and potential increased difficulty in raising new capital; and

decreases in the carrying value of our principal investments.

Furthermore, while difficult market conditions may increase opportunities to make certain distressed asset investments, such conditions also increase the risk of default with respect to investments held by our funds with debt investments, in particular the credit funds and the Castles. Our liquid hedge funds may also be adversely affected by difficult market conditions if they fail to predict the adverse effect of such conditions on particular investments, resulting in a significant reduction in the value of those investments.

**Changes in the debt financing markets may negatively impact the ability of our investment funds and their portfolio companies to obtain attractive financing or refinancing for their investments, and may increase the cost of such financing if it is obtained, leading to lower-yielding investments and potentially decreasing our incentive income.**

Over the past two years, the markets for debt financing have contracted significantly, particularly in the area of acquisition financings for private equity and leveraged buyout transactions as well as real estate related financings. Large commercial banks, which have traditionally provided such financing, have demanded higher rates, more restrictive covenants and generally more onerous terms (including posting additional margin)



## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

in order to provide such financing, and in some cases will not provide any financing for acquisitions which would have been readily financed under credit conditions present for the past several years.

In the event that Fortress private equity funds or credit PE funds are unable to obtain committed debt financing for potential acquisitions (including as a result of a default by our lenders on financing commitments they have provided to us) or can only obtain debt at an increased rate, this may prevent those funds from completing otherwise profitable acquisitions or may lower the profit that the funds would otherwise have achieved from such transactions, either of which could lead to a decrease in the incentive income earned by us. Similarly, the portfolio companies owned by the Fortress private equity funds regularly utilize the debt markets in order to obtain efficient financing for their operations. To the extent that the current credit markets have rendered such financing difficult or more expensive to obtain, this may negatively impact the operating performance of those portfolio companies and therefore the investment returns on our funds. In addition, to the extent that the current markets make it difficult or impossible to refinance debt that is maturing in the near term, the relevant portfolio company may face substantial doubt as to its status as a going concern (which may result in an event of default under various agreements) or be unable to repay such debt at maturity and may be forced to sell assets, undergo a recapitalization or seek bankruptcy protection.

Our Castles have historically relied on the structured finance and mortgage markets in order to obtain leverage and thereby increase the yield on substantially all of their investments. To the extent that volatility in those credit markets leads to a situation where financing of that type is unavailable or limited (as has been the case for Newcastle since mid 2007 and is currently the case for both Castles), our Castles may be unable to make new investments on a basis that is as profitable as during periods when such financing was available. Furthermore, it could significantly reduce the yield available for

## **Table of Contents**

reinvesting capital received from prior investments, thereby reducing profits. As a result of impairments recorded in connection with this market disruption, we do not expect to earn incentive income from the Castles for an indeterminate period of time.

Our hedge funds have historically relied on the structured finance markets in order to obtain leverage and thereby increase the yield on certain of their investments. To the extent that financing of that type continues to be unavailable or limited, our hedge funds may be unable to make certain types of investments as the yield on those investments will be outside of the funds' target range without leverage. This could reduce the overall rate of return such funds obtain in their investments and could lead to those hedge funds making fewer overall investments and slowing the rate of growth of the fee paying assets under management in those funds, and a commensurate decrease in the rate of growth of our management fees.

### **We and our funds are subject to counterparty default and concentration risks**

Our funds enter into numerous types of financing arrangements with a wide array of counterparties around the world, including loans, hedge contracts, swaps, repurchase agreements and other derivative and non-derivative contracts. The terms of these contracts are often customized and complex, and many of these arrangements occur in markets or relate to products that are not subject to regulatory oversight. In particular, some of our funds utilize prime brokerage arrangements with a relatively limited number of counterparties, which has the effect of concentrating the transaction volume (and related counterparty default risk) of these funds with these counterparties.

Our funds are subject to the risk that the counterparty to one or more of these contracts defaults, either voluntarily or involuntarily, on its performance under the contract. Any such default may occur rapidly and without notice to us. Moreover, if a counterparty defaults, we may be unable to take action to cover our exposure, either because we lack the contractual ability or because market conditions make it difficult to take effective action. This inability could occur in times of market stress consistent with the conditions we are currently experiencing, which are precisely the times when defaults may be most likely to occur.

In addition, our risk-management models may not accurately anticipate the impact of market stress or counterparty financial condition, and as a result, we may not take sufficient action to reduce our risks effectively. Although each of our funds monitors its credit exposures, default risk may arise from events or circumstances that are difficult to detect, foresee or evaluate. In addition, concerns about, or a default by, one large participant could lead to significant liquidity problems for other participants, which may in turn expose us to significant losses.

In the event of a counterparty default, particularly a default by a major investment bank, one or more of our funds could incur material losses, and the resulting market impact of a major counterparty default could harm our business, results of operation and financial condition. In the event that one of our counterparties becomes insolvent or files for bankruptcy, our ability to eventually recover any losses suffered as a result of that counterparty's default may be limited by the liquidity of the counterparty or the applicable legal regime governing the bankruptcy proceeding.

The counterparty risks that we face have increased in complexity and magnitude as a result of the significant deterioration of conditions in the financial markets and weakening or insolvency of a number of major financial institutions (such as Lehman Brothers and AIG) who serve as counterparties for derivative contracts, insurance policies and other financial instruments with us, our funds and our portfolio companies. For example, the consolidation and elimination of counterparties has increased our concentration of counterparty risk and decreased the universe of potential counterparties, and our funds are generally not restricted from dealing with any particular counterparty or from concentrating any or all of their transactions with one counterparty. In addition, counterparties have generally reacted to the ongoing market volatility by tightening their underwriting standards and increasing their margin requirements for all categories of financing, which has the result of decreasing the overall amount of leverage available to our funds and increasing the costs of borrowing. For additional detail on counterparty risks, please see We are subject to risks in using prime brokers and custodians.

Because the public company is dependent on receiving cash from our funds, any loss suffered by a fund as a result of a counterparty default would also affect the results of the public company. In addition, the board of directors of the public company has no ability to influence any fund's choice of, or the amount of a fund's exposure to, any given counterparty. As a result, our funds may have concentrated exposure to one or more counterparties and thus be exposed to a heightened risk of loss if that counterparty defaults. This may mean that the Company has a significant concentration of risk with one or more particular counterparties at any particular time when aggregate counterparty risk is measured across all of the various Fortress Funds.

**Investors in our hedge funds may redeem their investments, and investors in our private equity funds and credit PE funds may elect to dissolve the funds, at any time without cause. These events would lead to a decrease in our assets under management (and, therefore, our revenues), which could be substantial and could lead to a material adverse effect on our business.**



---

## Table of Contents

Investors in our hedge funds may generally redeem their investments on an annual or quarterly basis, subject to the applicable fund's specific redemption provisions. Investors may decide to move their capital away from us to other investments for any number of reasons in addition to poor investment performance. Factors that could result in investors leaving our funds include the need to increase available cash reserves or to fund other capital commitments, changes in interest rates that make other investments more attractive, the publicly traded nature of the indirect parent of their manager, changes in investor perception regarding our focus or alignment of interest, unhappiness with changes in or broadening of a fund's investment strategy, changes in our reputation, and departures or changes in responsibilities of key investment professionals. In a declining financial market, the pace of redemptions and consequent reduction in our fee paying assets under management could accelerate. The decrease in our revenues that would result from significant redemptions in our hedge fund business would have a material adverse effect on our business.

The decline in the financial markets during 2008, together with reduced liquidity in the credit markets and negative performance of many hedge funds, led to an increase in redemption requests from investors throughout the hedge fund industry, and a number of our funds have been affected by this trend during 2008 and, to a lesser extent, 2009. Our liquid hedge funds received redemption requests, including affiliates, for a total of \$0.4 billion during the six months ended June 30, 2010 and \$2.2 billion and \$5.5 billion during the years ended December 31, 2009 and 2008, respectively. Investors in our credit hedge funds are permitted to request that their capital be returned on an annual basis, and such returns of capital may be paid over time as the underlying investments are liquidated, in accordance with the governing documents of the applicable funds. Return of capital requests, including affiliates, for those credit hedge funds totaled approximately \$0.3 billion for the six months ended June 30, 2010 and \$1.5 billion and \$1.5 billion for the 2009 and 2008 notice dates, respectively. The return of capital notice dates for our flagship credit hedge fund and for our Fortress Partners Fund had not yet occurred as of June 30, 2010.

In addition, the investors in our private equity, credit PE and certain hedge funds may, subject to certain conditions, act at any time to accelerate the liquidation date of the fund without cause, resulting in a reduction in management fees we earn from such funds, and a significant reduction in the amounts of total incentive income we could earn from those funds. See Our removal as the investment manager, or the liquidation, of one or more of our funds could have a material negative effect on our business, results of operations and financial condition. Incentive income could be significantly reduced as a result of our inability to maximize the value of a fund's investments in a liquidation. The occurrence of such an event with respect to any of our funds would, in addition to the significant negative impact on our revenue and earnings, likely result in significant reputational damage as well.

### **The hedge fund industry was especially volatile during 2008, and our and other hedge funds may face significant volatility, redemptions and liquidity issues in the future.**

During 2008, market conditions negatively affected the hedge fund industry. Challenging market conditions made it difficult to produce positive returns, and a significant number of hedge funds posted negative results during that period. Poor investment performance, together with investors' increased need for liquidity given the state of the credit markets, prompted relatively high levels of investor redemptions at a time when many funds may not have had sufficient liquidity to satisfy some or all of their investor redemption requests. While conditions generally improved during 2009, conditions could deteriorate in the future to levels similar to or worse than the conditions experienced during 2008. Market volatility during the first half of 2010 has increased markedly again.

Our funds have various agreements that create debt or debt-like obligations (such as repurchase arrangements, ISDAs, credit default swaps and total return swaps, among others) with a material number of counterparties. Such agreements in many instances contain covenants or triggers that require our funds to maintain specified amounts of assets under management. Decreases in such funds' AUM (whether due to performance, redemption, or both) that breach such covenants may result in defaults under such agreements, and such defaults could permit the counterparties to take various actions that would be adverse to the funds, including terminating the financing arrangements, increasing the amount of margin or collateral that the funds are required to post (so-called supercollateralization requirements) or decreasing the aggregate amount of leverage that such counterparty is willing to provide to our funds. In particular, many such covenants to which our hedge funds are party are designed to protect against sudden and pronounced drops in AUM over specified periods, so if our funds were to receive larger-than-anticipated redemption requests during a period of poor performance, such covenants may be breached. Defaults under any such covenants would be likely to result in the affected funds being forced to sell financed assets (which sales would presumably occur in suboptimal or distressed market conditions) or otherwise raise cash by reducing other leverage, which would reduce the funds' returns and our opportunities to produce incentive income from the affected funds.

If conditions deteriorate, many funds may face additional redemption requests, which would exacerbate the liquidity pressures on the affected funds. If they cannot satisfy their current and future redemption requests, they may be forced to sell assets at distressed prices or cease operations. Various measures taken by funds to improve their liquidity profile (such as the implementation of gates or the suspension of redemptions) that reduce the amounts that would otherwise be paid out in response to redemption requests may have the affect of incentivizing investors to gross up or increase the size of



## **Table of Contents**

the future redemption request they make, thereby exacerbating the cycle of redemptions. The liquidity issues for such funds are often further exacerbated by their fee structures, as a decrease in AUM decreases their management fees. We cannot predict the effect that any conditions affecting the hedge fund industry may have on our funds. For additional information on the impact of market conditions on our hedge funds, see Risks Related to Our Funds.

**Many of our funds invest in relatively high-risk, illiquid assets that often have significantly leveraged capital structures, and we may fail to realize any profits from these activities for a considerable period of time or lose some or all of the principal amount we invest in these activities.**

Many of our funds invest in securities that are not publicly traded. In many cases, our funds may be prohibited by contract or by applicable securities laws from selling such securities for a period of time. Our funds will generally not be able to sell these securities publicly unless their sale is registered under applicable securities laws, or unless an exemption from such registration requirements is available. Accordingly, our funds may be forced to sell securities at a loss under certain conditions. The ability of many of our funds, particularly our private equity funds, to dispose of investments is heavily dependent on the public equity markets, inasmuch as our ability to realize any value from an investment may depend upon our ability to sell equity of the portfolio company in the public equity markets through an initial public offering or secondary public offering of shares of the portfolio company in which such investment is held.

Furthermore, large holdings even of publicly traded equity securities can often be disposed of only over a substantial period of time, exposing the investment returns to risks of downward movement in market prices during the disposition period. The illiquid nature of many of our funds assets may negatively affect a fund's ability to retain sufficient liquidity to satisfy its obligations as they become due. As a result, a fund with illiquid assets may be unable, for example, to generate sufficient liquidity to pay the management fees or other amounts due to the manager, which would, in turn, reduce the amounts we receive from our funds, thereby reducing the amount of funds available to us to satisfy our obligations, including our obligations under our credit agreement.

In addition, many of our funds invest in businesses with capital structures that have significant leverage. The large amount of borrowing in the leveraged capital structure of such businesses increases the risk of losses due to factors such as rising interest rates, downturns in the economy or deteriorations in the condition of the investment or its industry. In the event of defaults under borrowings, the assets being financed would be at risk of foreclosure, and the fund could lose its entire investment.

**Our funds are subject to risks due to potential illiquidity of assets.**

Our funds may make investments or hold trading positions in markets that are volatile and which may become illiquid. Timely divestiture or sale of trading positions can be impaired by decreased trading volume, increased price volatility, concentrated trading positions, limitations on the ability to transfer positions in highly specialized or structured transactions to which we may be a party, and changes in industry and government regulations. When a fund holds a security or position it is vulnerable to price and value fluctuations and may experience losses to the extent the value of the position decreases and it is unable to timely sell, hedge or transfer the position. Therefore, it may be impossible or costly for our funds to liquidate positions rapidly, particularly if the relevant market is moving against a position or in the event of trading halts or daily price movement limits on the market or otherwise. Alternatively, it may not be possible in certain circumstances for a position to be purchased or sold promptly, particularly if there is insufficient trading activity in the relevant market or otherwise.

The funds we manage may operate with a substantial degree of leverage. They may borrow, invest in derivative instruments and purchase securities using borrowed money, so that the positions held by the funds may in aggregate value exceed the net asset value of the funds. This leverage creates the potential for higher returns, but also increases the volatility of a fund, including the risk of a total loss of the amount invested. In addition, our private equity funds have historically leveraged some of their investments in order to return capital to investors earlier than would have otherwise been possible without a sale of the asset. In many such cases, such debt was secured by publicly-traded stock of portfolio companies. To the extent that the value of such collateral decreases due to decreases in the share price of such portfolio companies, our funds may be subject to margin calls that require them to call additional capital from investors, sell assets or otherwise take actions that decrease the overall return of the impacted funds. Such actions would result in overall decreased revenues for us and a lower likelihood of generating incentive income from the affected investments.

The risks identified above will be increased if a fund is required to rapidly liquidate positions to meet redemption requests, margin requests, margin calls or other funding requirements on that position or otherwise. The inability to rapidly sell positions due to a lack of liquidity has historically been the cause of substantial losses in the hedge fund industry. The ability of counterparties to force liquidations following losses or a failure to meet a margin call can result in the rapid sale of highly leveraged positions in declining markets, which would likely subject our hedge funds to substantial losses. We may fail to adequately predict the liquidity that our funds require to address counterparty requirements due to falling values



## **Table of Contents**

of fund investments being financed by such counterparties, which could result not only in losses related to such investments, but in losses related to the need to liquidate unrelated investments in order to meet the fund's obligations. Our funds may incur substantial losses in the event significant capital is invested in highly leveraged investments or investment strategies. Such losses would result in a decline in AUM, lead to investor requests to redeem remaining AUM (in the case of our hedge funds), and damage our reputation, each of which would materially and adversely impact our earnings.

### **Valuation methodologies for certain assets in our funds can be subject to significant subjectivity and the values of assets established pursuant to such methodologies may never be realized, which could result in significant losses for our funds.**

There are no readily-ascertainable market prices for a very large number of illiquid investments in our private equity and, to a lesser extent, credit funds as well as a small number of so-called "sidepocket" investments in our liquid hedge funds. The fair value of such investments of our funds is determined periodically by us based on the methodologies described in the funds' valuation policies. These policies are based on a number of factors, including the nature of the investment, the expected cash flows from the investment, bid or ask prices provided by third parties for the investment, the length of time the investment has been held, the trading price of securities (in the case of publicly traded securities), restrictions on transfer and other recognized valuation methodologies. The methodologies we use in valuing individual investments are based on a variety of estimates and assumptions specific to the particular investments, and actual results related to the investment therefore often vary materially as a result of the inaccuracy of such assumptions or estimates. In addition, because many of the illiquid investments held by our funds are in industries or sectors which are unstable, in distress, or undergoing some uncertainty, such investments are subject to rapid changes in value caused by sudden company-specific or industry-wide developments. In addition, in many markets, transaction flow is limited due to uncertainty about accurate asset valuations which may cause hedge fund investors to become concerned about valuations of funds that have illiquid or hard-to-value assets. This concern may lead to increased redemptions by investors irrespective of the performance of the funds. In addition, uncertainty about asset values on redemptions from our investments in our hedge funds may lead to an increased risk of litigation by investors over net asset values.

Because there is significant uncertainty in the valuation of, or in the stability of the value of, illiquid investments, the fair values of such investments as reflected in a fund's net asset value do not necessarily reflect the prices that would actually be obtained by us on behalf of the fund when such investments are sold. Realizations at values significantly lower than the values at which investments have been reflected in fund net asset values would result in losses for the applicable fund, a decline in asset management fees and the loss of potential incentive income. Also, a situation where asset values turn out to be materially different than values reflected in fund net asset values could cause investors to lose confidence in us which would, in turn, result in redemptions from our hedge funds or difficulties in raising additional private equity funds and credit PE funds.

### **Certain of our funds utilize special situation, distressed debt and mortgage-backed investment strategies that involve significant risks.**

Our private equity and credit funds invest in obligors and issuers with weak financial conditions, poor operating results, substantial financial needs, negative net worth, and/or special competitive problems. These funds also invest in obligors and issuers that are involved in bankruptcy or reorganization proceedings. With such investments, it may be difficult to obtain full information as to the exact financial and operating conditions of these obligors and issuers. Additionally, the fair values of such investments are subject to abrupt and erratic market movements and significant price volatility if they are widely traded securities, and are subject to significant uncertainty in general if they are not widely traded securities or may have no recognized market. A fund's exposure to such investments may be substantial in relation to the market for those investments, and the assets are likely to be illiquid and difficult to sell or transfer. As a result, it may take a number of years for the fair value of such investments to ultimately reflect their intrinsic value as perceived by us. For example, several of our funds, including a number of funds targeted specifically toward residential mortgage backed securities and similar investments, have significant investments in mortgage backed securities and other investments that are directly or indirectly related to the value of real estate in various locations around the world, particularly in the United States. As a result, the results of a number of our funds have been and may continue to be affected, in some cases materially, by fluctuations in the value of real estate and real estate related investments. Such fluctuations could have a meaningful impact on the performance of the applicable fund and potentially on the operating results of the public company.

A central feature of our distressed investment strategy is our ability to successfully predict the occurrence of events such as mortgage default rates, mortgage prepayment rates, the amounts of any prepayments, maturity extensions, interest rates for mortgage-backed securities and similar instruments as well as corporate events such as capital raises, restructurings, reorganizations, mergers and other transactions. Predicting any of these data points is difficult, and if our analyses are inaccurate, the actual results of such investments could be materially lower than expected and the applicable fund's investment results could decline sharply.



---

## **Table of Contents**

The U.S. government has enacted legislation that enables government agencies to modify the terms of a significant number of residential and other loans to provide relief to borrowers without the applicable investor's consent. These modifications allow for outstanding principal to be deferred, interest rates to be reduced, the length of the loan to be extended or other terms to be changed in ways that can permanently eliminate the cash flow (principal and interest) associated with a portion of the loan. These modifications are currently reducing, or in the future may reduce, the value of a tremendous number of mortgage-backed securities and other investments, including investments held by a number of our funds. As a result, such loan modifications are negatively affecting the business, results of operations and financial condition of some of our funds. In addition, certain market participants propose reducing the amount of paperwork required by a borrower to modify their loan, which could increase the likelihood of fraudulent modifications and materially harm the U.S. mortgage market and funds that have exposure to this market.

In addition, these investments could subject our private equity, credit and hedge funds to certain potential additional liabilities that may exceed the value of their original investment. Under certain circumstances, payments or distributions on certain investments may be reclaimed if any such payment or distribution is later determined to have been a fraudulent conveyance, a preferential payment or similar transaction under applicable bankruptcy and insolvency laws. In addition, under certain circumstances, a lender that has inappropriately exercised control of the management and policies of a debtor may have its claims subordinated or disallowed, or may be found liable for damages suffered by parties as a result of such actions. In the case where the investment in securities of troubled companies is made in connection with an attempt to influence a restructuring proposal or plan of reorganization in bankruptcy, our funds may become involved in substantial litigation.

### **If our risk management systems for our fund business are ineffective, we may be exposed to material unanticipated losses.**

In our fund business, we continue to refine our risk management techniques, strategies and assessment methods. However, our risk management techniques and strategies do not fully mitigate the risk exposure of our funds in all economic or market environments, or against all types of risk, including risks that we might fail to identify or anticipate. Some of our strategies for managing risk in our funds are based upon our use of historical market behavior statistics. We apply statistical and other tools to these observations to measure and analyze the risks to which our funds are exposed. Any failures in our risk management techniques and strategies to accurately quantify such risk exposure could limit our ability to manage risks in the funds or to seek adequate risk-adjusted returns. In addition, any risk management failures could cause fund losses to be significantly greater than the historical measures predict. Further, our mathematical modeling does not take all risks into account. Our more qualitative approach to managing those risks could prove insufficient, exposing us to material unanticipated losses.

### **Some of our funds invest in foreign countries and securities of issuers located outside of the United States, which may involve foreign exchange, political, social and economic uncertainties and risks.**

Some of our funds invest a portion of their assets in the equity, debt, loans or other securities of issuers located outside the United States. In addition to business uncertainties, such investments may be affected by changes in exchange values as well as political, social and economic uncertainty affecting a country or region. Many financial markets are not as developed or as efficient as those in the U.S., and as a result, liquidity may be reduced and price volatility may be higher in those markets than in more developed markets. The legal and regulatory environment may also be different, particularly with respect to bankruptcy and reorganization, and may afford us less protection as a creditor than we may be entitled to under U.S. law. Financial accounting standards and practices may differ, and there may be less publicly available information in respect of such companies.

Restrictions imposed or actions taken by foreign governments may adversely impact the value of our fund investments. Such restrictions or actions could include exchange controls, seizure or nationalization of foreign deposits and adoption of other governmental restrictions which adversely affect the prices of securities or the ability to repatriate profits on investments or the capital invested itself. Income received by our funds from sources in some countries may be reduced by withholding and other taxes. Any such taxes paid by a fund will reduce the net income or return from such investments. While our funds will take these factors into consideration in making investment decisions, including when hedging positions, no assurance can be given that the funds will be able to fully avoid these risks or generate sufficient risk-adjusted returns.

### **Investments by our funds will frequently rank junior to investments made by others in the same company.**

In most cases, the companies in which our investment funds invest will have indebtedness or equity securities, or may be permitted to incur indebtedness or to issue equity securities, that rank senior to our investment. By their terms, such instruments may provide that their holders are entitled to receive payments of dividends, interest or principal on or before the dates on which payments are to be made in respect of our investment. Also, in the event of insolvency, liquidation,



## **Table of Contents**

dissolution, reorganization or bankruptcy of a company in which an investment is made, holders of securities ranking senior to our investment would typically be entitled to receive payment in full before distributions could be made in respect of our investment. After repaying senior security holders, the company may not have any remaining assets to use for repaying amounts owed in respect of our fund's investment. To the extent that any assets remain, holders of claims that rank equally with our investment would be entitled to share on an equal and ratable basis in distributions that are made out of those assets. Also, during periods of financial distress or following an insolvency, the ability of our investment funds to influence a company's affairs and to take actions to protect their investments may be substantially less than that of the senior creditors.

### **Our fund investments are subject to numerous additional risks.**

Our fund investments, including investments by our funds of hedge funds in other hedge funds, are subject to numerous additional risks, including the following:

Certain of the funds are newly established funds without any operating history or are managed by management companies or general partners who do not have a significant track record as an independent manager.

Generally, there are few limitations on the execution of our funds' investment strategies, which are, in some cases, subject to the sole discretion of the management company or the general partner of such funds. The execution of a particular fund's strategy—for example a strategy involving the enforcement of property rights through litigation—may negatively impact one or more other Fortress funds.

Our funds may engage in short-selling, which is subject to the theoretically unlimited risk of loss because there is no limit on how much the price of a security may appreciate before the short position is closed out. A fund may be subject to losses if a security lender demands return of the lent securities and an alternative lending source cannot be found or if the fund is otherwise unable to borrow securities that are necessary to hedge its positions.

Our funds are exposed to the risk that a counterparty will not settle a transaction in accordance with its terms and conditions because of a dispute over the terms of the contract (whether or not bona fide) or because of a credit or liquidity problem, thus causing the fund to suffer a loss. Counterparty risk is increased for contracts with longer maturities where events may intervene to prevent settlement, or where the fund has concentrated its transactions with a single or small group of counterparties. Generally, funds are not restricted from dealing with any particular counterparty or from concentrating any or all of their transactions with one counterparty. Moreover, the funds' internal consideration of the creditworthiness of their counterparties may prove insufficient. The absence of a regulated market to facilitate settlement may increase the potential for losses.

Credit risk may arise through a default by one of several large institutions that are dependent on one another to meet their liquidity or operational needs, so that a default by one institution causes a series of defaults by the other institutions. This systemic risk may adversely affect the financial intermediaries (such as clearing agencies, clearing houses, banks, investment banks, securities firms and exchanges) with which the funds interact on a daily basis.

The efficacy of investment and trading strategies depend largely on the ability to establish and maintain an overall market position in a combination of financial instruments. A fund's trading orders may not be executed in a timely and efficient manner due to various circumstances, including systems failures or human error. In such event, the funds might only be able to acquire some but not all of the components of the position, or if the overall position were to need adjustment, the funds might not be able to make such adjustment. As a result, the funds would not be able to achieve the market position selected by the management company or general partner of such funds, and might incur a loss in liquidating their position.

Fund investments are subject to risks relating to investments in commodities, futures, options and other derivatives, the prices of which are highly volatile and may be subject to the theoretically unlimited risk of loss in certain circumstances, including if the fund

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

writes a call option. Price movements of commodities, futures and options contracts and payments pursuant to swap agreements are influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments and national and international political and economic events and policies. The value of futures, options and swap agreements also depends upon the price of the commodities underlying them. In addition, hedge funds assets are subject to the risk of the failure of any of the exchanges on which their positions trade or of their clearinghouses or counterparties. Most U.S. commodities exchanges limit fluctuations in certain commodity interest prices during a single day by imposing daily price fluctuation limits or daily limits, the existence of which may reduce liquidity or effectively curtail trading in particular markets.

---

## **Table of Contents**

### **We have been engaged as the investment manager of a third-party investment fund, and we may be engaged as the investment manager of third-party investment funds or managed accounts in the future, and each such engagement exposes us to a number of potential risks.**

Changes within the alternative asset management industry may cause investors of some funds to replace their existing fund or managed account managers or may cause certain such managers to resign. In such instances, we may seek to be engaged as investment manager of these funds or accounts. For example, in May 2009, we became the investment manager of certain investment funds and accounts previously managed by D.B. Zwirn & Co., L.P.

While being engaged as investment manager of existing third-party funds or accounts potentially enables us to grow our business, it also entails a number of risks that could harm our reputation, results of operations and financial condition. For example, we may choose not to, or be unable to, conduct significant due diligence of the fund and its investments, and any diligence we undertake may not reveal all relevant facts that may be necessary or helpful in evaluating such investment opportunity. We may be unable to complete such transactions, which could harm our reputation and subject us to costly litigation. We may willingly or unknowingly assume actual or contingent liability for significant expenses, we may become subject to new laws and regulations with which we are not familiar, and we may become subject to increased risk of litigation, regulatory investigation or negative publicity. For example, we have been named as a defendant in litigation relating to the Zwirn portfolio, although we were not the manager of the relevant fund at the time of the prior events described in the complaint, and as part of our role as manager, we incur the time and expense of defending this and any similar future litigation. In addition to defending against litigation, being engaged as investment manager may require us to invest significant capital and other resources for various other reasons, which could detract from our existing funds or our ability to capitalize on future opportunities. In addition, being engaged as investment manager may require us to integrate complex technological, accounting and management systems, which may be difficult, expensive and time-consuming and which we may not be successful in integrating into our current systems. If we include the financial performance of funds for which we have been engaged as the investment manager in our public filings, we are subject to the risk that, particularly during the period immediately after the engagement, this information may prove to be inaccurate or incomplete. The occurrence of any of these negative integration events could negatively impact our reputation with both regulators and investors, which could, in turn, subject us to additional regulatory scrutiny and impair our relationships with the investment community. The occurrence of any of these problems could negatively affect our reputation, financial condition and results of operations.

### **We are subject to risks in using prime brokers and custodians.**

The funds in our hedge fund business depend on the services of prime brokers and custodians to carry out certain securities transactions. In the event of the insolvency of a prime broker and/or custodian, the funds might not be able to recover equivalent assets in full as they will rank among the prime broker and custodian's unsecured creditors in relation to assets which the prime broker or custodian borrows, lends or otherwise uses. In addition, the funds' cash held with a prime broker or custodian will not be segregated from the prime broker's or custodian's own cash, and the funds will therefore rank as unsecured creditors in relation to the cash they have deposited.

Some of our funds had prime brokerage accounts with Lehman Brothers at the time it declared insolvency. These funds are currently working to obtain any assets or funds that are owed by Lehman Brothers to the fund. However, due to the sudden nature of Lehman's insolvency, the complexity and ambiguity of both the contractual arrangements and applicable regulations, this process will take time, may be expensive and may result in one or more funds receiving only a portion of the amount they are owed (or potentially receiving nothing at all). Moreover, the suddenness of Lehman's failure and resulting lack of complete information about the status of certain trades made by our funds created uncertainty as to whether certain trades were appropriately hedged. As our funds were forced to make investment decisions with imperfect information, investment decisions may have resulted in certain positions being imperfectly hedged or otherwise hedged in a manner that is inconsistent with the fund's general investment guidelines.

### ***Risks Related to Our Organization and Structure***

#### **Control by our principals of the combined voting power of our shares and holding their economic interest through Fortress Operating Group may give rise to conflicts of interests.**

Our principals control a majority of the combined voting power of our Class A and Class B shares. Accordingly, our principals have the ability to elect all of the members of our board of directors, subject to Nomura's right to nominate one designee, and thereby to control our management and affairs. In addition, they are able to determine the outcome of all matters requiring shareholder approval and are able to cause or prevent a change of control of our company or a change in the composition of our board of directors, and could preclude any unsolicited acquisition of our company. The control of voting power by our principals could deprive Class A shareholders of an opportunity to receive a premium for their Class A shares as part of a sale of our company, and might ultimately affect the market price of the Class A shares.

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

In addition, the shareholders agreement among us and the principals provides the principals, who are then employed by the Fortress Operating Group and who hold shares representing greater than 50% of the total combined voting power of all shares held by such principals, so long as the principals and their permitted transferees continue to hold more than 40% of the total combined voting power of our outstanding Class A and Class B shares, with approval rights over a variety of significant corporate actions, including:

ten percent indebtedness: any incurrence of indebtedness, in one transaction or a series of related transactions, by us or any of our subsidiaries in an amount in excess of approximately 10% of the then existing long-term indebtedness of us and our subsidiaries;

---

**Table of Contents**

ten percent share issuance: any issuance by us, in any transaction or series of related transactions, of equity or equity-related securities which would represent, after such issuance, or upon conversion, exchange or exercise, as the case may be, at least 10% of the total combined voting power of our outstanding Class A and Class B shares other than (1) pursuant to transactions solely among us and our wholly-owned subsidiaries, or (2) upon conversion of convertible securities or upon exercise of warrants or options, which convertible securities, warrants or options are either outstanding on the date of, or issued in compliance with, the shareholders agreement;

investment of \$250 million or greater: any equity or debt commitment or investment or series of related equity or debt commitments or investments in an entity or related group of entities in an amount greater than \$250 million;

new business requiring investment in excess of \$100 million: any entry by us or any of our controlled affiliates into a new line of business that does not involve investment management and that requires a principal investment in excess of \$100 million;

the adoption of a shareholder rights plan;

any appointment of a chief executive officer or co-chief executive officer; or

the termination of the employment of a principal with us or any of our material subsidiaries without cause.

Furthermore, the principals have certain consent rights with respect to structural changes involving our company.

In addition, our principals are entitled to a majority of our economic returns through their holdings of Fortress Operating Group units. Because they hold their economic interest in our business directly through Fortress Operating Group, rather than through the public company, our principals may have conflicting interests with holders of Class A shares. For example, our principals may have different tax positions from us which could influence their decisions regarding whether and when to dispose of assets, and whether and when to incur new or refinance existing indebtedness, especially in light of the existence of the tax receivable agreement. In addition, the structuring of future transactions may take into consideration the principals' tax considerations even where no similar benefit would accrue to us. Moreover, any distribution by the Fortress Operating Group to us to satisfy our tax obligations will result in a corresponding pro rata distribution to our principals.

**Our ability to pay regular dividends may be limited by our holding company structure; we are dependent on distributions from the Fortress Operating Group to pay dividends, taxes and other expenses. Our ability to pay dividends is significantly restricted by, and is also subject to not defaulting on, our credit agreement.**

As a holding company, our ability to pay dividends is subject to the ability of our subsidiaries to provide cash to us. When we declare a dividend on our Class A shares, we expect to cause the Fortress Operating Group to make distributions to its unitholders, including our wholly-owned subsidiaries, pro rata in an amount sufficient to enable us to pay such dividends to our Class A shareholders. However, no assurance can be given that such distributions will or can be made. Our board can reduce or eliminate our dividend at any time, in its discretion, and our board determined not to pay any dividend to our Class A shareholders from the third quarter of 2008 through the first quarter of 2010. In addition, Fortress Operating Group is required to make minimum tax distributions to its unitholders. See also [Risks Related to Taxation](#). There can be no assurance that amounts paid as dividends on Class A shares will be sufficient to cover the tax liability arising from ownership of Class A shares. If Fortress Operating Group has insufficient funds, we may have to borrow additional funds or sell assets, which could materially adversely affect our liquidity and financial condition. In addition, Fortress Operating Group's earnings may be insufficient to enable it to make required minimum tax distributions to unitholders.

We are also subject to certain contingent repayment obligations that may affect our ability to pay dividends. We earn incentive income generally 20% of the profits from each of our private equity funds and credit PE funds based on a percentage of the profits earned by the fund as a whole, provided that the fund achieves specified performance criteria. We generally receive, however, our percentage share of the profits on each investment in the fund as it is realized, before it is known with certainty that the fund as a whole will meet the specified criteria. As a result, the incentive income paid to us as a particular investment made by the funds is realized is subject to contingent repayment (or [clawback](#)) if, upon liquidation of the fund, the aggregate amount paid to us as incentive income exceeds the amount actually due to us based upon the aggregate performance of the fund. If we are required to repay amounts to a fund in order to satisfy a clawback obligation, any such repayment will reduce

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

the amount of cash available to distribute as a dividend to our Class A shareholders. While the principals have personally guaranteed, subject to certain limitations, this clawback obligation, our shareholders agreement with them contains our agreement to indemnify the principals for all amounts which the principals pay pursuant to any of these personal guarantees in favor of our private equity funds and credit PE funds. Consequently, any requirement to satisfy a clawback obligation could impair our ability to pay dividends on our Class A shares.



**Table of Contents**

There may also be circumstances under which we are restricted from paying dividends under applicable law or regulation (for example due to Delaware limited partnership or limited liability company act limitations on making distributions if liabilities of the entity after the distribution would exceed the value of the entity's assets). In addition, under our current credit agreement, our ability to pay dividends is restricted by the amortization requirements in our credit agreement and the requirement that we use 75%, or, in certain circumstances, 50%, of our free cash flow (as defined in the agreement) to make amortization payments. Under our current credit agreement, we are permitted to make cash distributions subject to the following additional restrictions: (a) no event of default exists immediately prior to or subsequent to the distribution and (b) after giving effect to the distribution, we have cash on hand of not less than accrued but unpaid taxes (based on estimated entity level taxes due and payable by the Fortress Operating Group entities, primarily New York City unincorporated business tax) and amortization obligations (including scheduled principal payments) under the credit agreement which are required in the next 90 days. The events of default under the credit agreement are typical of such agreements and include payment defaults, failure to comply with credit agreement covenants (including a leverage covenant that is negatively affected by realized losses), cross-defaults to material indebtedness, bankruptcy and insolvency, change of control, and adverse events with respect to our material funds. Our lenders may also attempt to exercise their security interests over substantially all of the assets of the Fortress Operating Group upon the occurrence of an event of default.

**Tax consequences to the principals may give rise to conflicts of interests.**

As a result of unrealized built-in gain attributable to the value of our assets held by the Fortress Operating Group entities at the time of our initial public offering, upon the sale or, refinancing or disposition of the assets owned by the Fortress Operating Group entities, our principals will incur different and significantly greater tax liabilities as a result of the disproportionately greater allocations of items of taxable income and gain to the principals upon a realization event. As the principals will not receive a corresponding greater distribution of cash proceeds, they may, subject to applicable fiduciary or contractual duties, have different objectives regarding the appropriate pricing, timing and other material terms of any sale, refinancing, or disposition, or whether to sell such assets at all. Decisions made with respect to an acceleration or deferral of income or deductions or the sale or disposition of assets may also influence the timing and amount of payments that are received by an exchanging or selling principal under the tax receivable agreement. All other factors being equal, earlier disposition of assets following a transaction will tend to accelerate such payments and increase the present value of the tax receivable agreement, and disposition of assets before a transaction will increase a principal's tax liability without giving rise to any rights to receive payments under the tax receivable agreement. Decisions made regarding a change of control also could have a material influence on the timing and amount of payments received by the principals pursuant to the tax receivable agreement.

**We are required to pay our principals for most of the tax benefits we realize as a result of the tax basis step-up we receive in connection with taxable exchanges by our principals of units held in the Fortress Operating Group entities or our acquisitions of units from our principals.**

At any time and from time to time, each principal has the right to exchange his Fortress Operating Group units for our Class A shares in a taxable transaction. These taxable exchanges, as well as our acquisitions of units from our principals, may result in increases in the tax depreciation and amortization deductions, as well as an increase in the tax basis of other assets, of the Fortress Operating Group that otherwise would not have been available. These increases in tax depreciation and amortization deductions, as well as the tax basis of other assets, may reduce the amount of tax that FIG Corp. or FIG Asset Co. LLC and any other corporate taxpayers would otherwise be required to pay in the future, although the IRS may challenge all or part of increased deductions and tax basis increase, and a court could sustain such a challenge.

We have entered into a tax receivable agreement with our principals that provides for the payment by the corporate taxpayers to our principals of 85% of the amount of tax savings, if any, 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 discussed below) as a result of these increases in tax deductions and tax basis of the Fortress Operating Group. The payments that the corporate taxpayers may make to our principals could be material in amount.

Although we are not aware of any issue that would cause the IRS to challenge a tax basis increase, our principals will not reimburse the corporate taxpayers for any payments that have been previously made under the tax receivable agreement. As a result, in certain circumstances, payments could be made to our principals under the tax receivable agreement in excess of the corporate taxpayers' cash tax savings. The corporate taxpayers' ability to achieve benefits from any tax basis increase, and the payments to be made under this agreement, will depend upon a number of factors, including the timing and amount of our future income.

---

## **Table of Contents**

In addition, the tax receivable agreement provides that, upon a merger, asset sale or other form of business combination or certain other changes of control, the corporate taxpayers (or their successors) obligations with respect to exchanged or acquired units (whether exchanged or acquired before or after such change of control) would be based on certain assumptions, including that the corporate taxpayers would have sufficient taxable income to fully utilize the deductions arising from the increased tax deductions and tax basis and other benefits related to entering into the tax receivable agreement.

**If we were deemed an investment company under the Investment Company Act of 1940, applicable restrictions could make it impractical for us to continue our business as contemplated and could have a material adverse effect on our business and the price of our Class A shares.**

We do not believe that we are an investment company under the Investment Company Act of 1940 because the nature of our assets and the sources of our income exclude us from the definition of an investment company pursuant to Rule 3a-1 under the Investment Company Act of 1940. In addition, we believe the company is not an investment company under Section 3(b)(1) of the Investment Company Act because it is primarily engaged in a non-investment company business. If one or more of the Fortress Operating Group entities ceased to be a wholly-owned subsidiary of ours, our interests in those subsidiaries could be deemed an investment security for purposes of the Investment Company Act of 1940. Generally, a person is an investment company if it owns investment securities having a value exceeding 40% of the value of its total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. We intend to conduct our operations so that we will not be deemed an investment company. However, if we were to be deemed an investment company, restrictions imposed by the Investment Company Act of 1940, including limitations on our capital structure and our ability to transact with affiliates, could make it impractical for us to continue our business as contemplated and would have a material adverse effect on our business and the price of our Class A shares.

### ***Risks Related To Our Class A Shares***

**The market price and trading volume of our Class A shares may be volatile, which could result in rapid and substantial losses for our shareholders.**

The market price of our Class A shares recently has been, and in the future, may be highly volatile and could be subject to wide fluctuations. In addition, the trading volume in our Class A shares may fluctuate and cause significant price variations to occur, which may limit or prevent investors from readily selling their Class A shares and may otherwise negatively affect the liquidity of our Class A shares. If the market price of our Class A shares declines significantly, holders may be unable to resell their Class A shares at or above their purchase price, if at all. We cannot provide any assurance that the market price of our Class A shares will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect the price of our Class A shares or result in fluctuations in the price or trading volume of our Class A shares include:

variations in our quarterly operating results or dividends, or a decision to continue not paying a regular dividend;

failure to meet analysts' earnings estimates;

sales by the company, key executives or other shareholders of a significant amount of our equity securities;

difficulty in complying with the provisions in our credit agreement such as financial covenants and amortization requirements;

publication of research reports or press reports about us, our investments or the investment management industry or the failure of securities analysts to cover our Class A shares;

additions or departures of our principals and other key management personnel;

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

adverse market reaction to any indebtedness we may incur or securities we may issue in the future;

actions by shareholders;

changes in market valuations of similar companies;

speculation in the press or investment community;

changes or proposed changes in laws or regulations or differing interpretations thereof affecting our business or enforcement of these laws and regulations, or announcements relating to these matters;

litigation or governmental investigations;

fluctuations in the performance or share price of other alternative asset managers;

poor performance or other complications affecting our funds or current or proposed investments;

adverse publicity about the asset management industry generally, our specific funds or investments, or individual scandals, specifically;

general market and economic conditions; and

dilution resulting from the issuance of equity-based compensation to employees

In addition, when the market price of a stock has been volatile in the past, holders of that stock have, at times, instituted securities class action litigation against the issuer of the stock. If any of our shareholders brought a lawsuit against us, we may be required to incur substantial costs defending any such suit, even those without merit. Such a lawsuit could also divert the time and attention of our management from our business and lower our Class A share price.

---

**Table of Contents**

**Our Class A share price may decline due to the large number of shares eligible for future sale and for exchange into Class A shares.**

The market price of our Class A shares could decline as a result of sales of a large number of our Class A shares or the perception that such sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for us to sell equity securities in the future at a time and price that we deem appropriate. As of June 30, 2010, we had 464,884,069 outstanding Class A shares on a fully diluted basis, including 12,145,051 resulting from vested equity compensation, 47,138,673 restricted Class A share units granted to employees and affiliates (net of forfeitures), 426,669 restricted Class A shares granted to directors pursuant to our equity incentive plan, and 60,158,160 Class A shares and Fortress Operating Group units that remain available for future grant under our equity incentive plan. Approximately 11.4 million restricted Class A share units granted to Fortress employees and affiliates vested on January 1, 2010, and became eligible for resale by the holders, with a similar amount vesting on each of the three succeeding anniversaries of that date. The Class A shares reserved under our equity incentive plan is increased on the first day of each fiscal year during the plan's term by the lesser of (x) the excess of (i) 15% of the number of outstanding Class A and Class B shares of the company on the last day of the immediately preceding fiscal year over (ii) the number of shares reserved and available for issuance under our equity incentive plan as of such date or (y) 60,000,000 shares. In January 2010, the number of shares reserved for issuance pursuant to this calculation increased by 4,868,553 shares. We may issue and sell in the future additional Class A shares or any securities issuable upon conversion of or exchange or exercise for, Class A shares (including Fortress Operating Group units) at any time.

In addition, in April 2008, Fortress granted 31,000,000 Fortress Operating Group restricted partnership units ( RPU s ) to a senior employee. The RPUs will vest into full capital interests in Fortress Operating Group units in three equal portions on the first business day of 2011, 2012 and 2013, respectively, subject to continued employment with Fortress. If and when vested, these 31,000,000 Fortress Operating Group units will be exchangeable into Class A shares on a one-for-one basis. In addition, such units will have the same resale terms and restrictions as those applicable to the principals' Fortress Operating Group units.

Our principals directly own an aggregate of 300,273,852 Fortress Operating Group units and also own an aggregate of 5,486,895 Class A shares. Each principal has the right to exchange each of his directly owned Fortress Operating Group units for one of our Class A shares at any time, subject to the Principals Agreement. These Class A shares and Fortress Operating Group units are eligible for resale from time to time, subject to certain contractual restrictions and Securities Act limitations.

Our principals and Nomura are parties to shareholders agreements with us. The principals have the ability to cause us to register the Class A shares they acquire upon exchange for their Fortress Operating Group units. Nomura has the ability to cause us to register any of the 55,071,450 Class A shares it purchased prior to our initial public offering. Nomura also purchased 5,400,000 Class A shares in our May 2009 offering.

**Our principals' beneficial ownership of Class B shares and anti-takeover provisions in our charter documents and Delaware law could delay or prevent a change in control.**

Our principals beneficially own all of our Class B shares. The principals' Class B shares represent a majority of the total combined voting power of our outstanding Class A and Class B shares. As a result, if they vote all of their shares in the same manner, they will be able to exercise control over all matters requiring the approval of shareholders and will be able to prevent a change in control of our company. In addition, provisions in our operating agreement may make it more difficult and expensive for a third party to acquire control of us even if a change of control would be beneficial to the interests of our shareholders. For example, our operating agreement provides for a staggered board, requires advance notice for proposals by shareholders and nominations, places limitations on convening shareholder meetings, and authorizes the issuance of preferred shares that could be issued by our board of directors to thwart a takeover attempt. In addition, certain provisions of Delaware law may delay or prevent a transaction that could cause a change in our control. The market price of our Class A shares could be adversely affected to the extent that our principals' control over us, as well as provisions of our operating agreement, discourage potential takeover attempts that our shareholders may favor.

**There are certain provisions in our operating agreement regarding exculpation and indemnification of our officers and directors that differ from the Delaware General Corporation Law (DGCL) in a manner that may be less protective of the interests of our Class A shareholders.**

Our operating agreement provides that to the fullest extent permitted by applicable law our directors or officers will not be liable to us. However, under the DGCL, a director or officer would be liable to us for (i) breach of duty of loyalty to us or

---

## **Table of Contents**

our shareholders, (ii) intentional misconduct or knowing violations of the law that are not done in good faith, (iii) improper redemption of shares or declaration of dividend, or (iv) a transaction from which the director or officer derived an improper personal benefit. In addition, our operating agreement provides that we indemnify our directors and officers for acts or omissions to the fullest extent provided by law. However, under the DGCL, a corporation can only indemnify directors and officers for acts or omissions if the director or officer acted in good faith, in a manner he reasonably believed to be in the best interests of the corporation, and, in a criminal action, if the officer or director had no reasonable cause to believe his conduct was unlawful. Accordingly, our operating agreement may be less protective of the interests of our Class A shareholders, when compared to the DGCL, insofar as it relates to the exculpation and indemnification of our officers and directors.

**We have elected to become a controlled company within the meaning of the New York Stock Exchange rules and, as a result, will qualify for, and may rely on, exemptions from certain corporate governance requirements.**

A company of which more than 50% of the voting power is held by an individual, a group or another company is a controlled company within the meaning of the New York Stock Exchange rules and may elect not to comply with certain corporate governance requirements of the New York Stock Exchange, including:

the requirement that a majority of our board of directors consist of independent directors;

the requirement that we have a nominating/corporate governance committee that is composed entirely of independent directors; and

the requirement that we have a compensation committee that is composed entirely of independent directors.

We have elected to become a controlled company within the meaning of the New York Stock Exchange rules, and we intend to rely on one or more of the exemptions listed above. For example, our board is not currently, and likely in the future will not be, comprised of a majority of independent directors. Accordingly, you will not have the same protections afforded to stockholders of companies that are subject to all of the corporate governance requirements of the New York Stock Exchange.

### *Risks Related to Taxation*

**Class A shareholders may be subject to U.S. federal income tax on their share of our taxable income, regardless of whether they receive any cash dividends from us.**

So long as we are not required to register as an investment company under the Investment Company Act of 1940 and 90% of our gross income for each taxable year constitutes qualifying income within the meaning of the Internal Revenue Code of 1986, as amended (the Code), on a continuing basis, we will be treated, for U.S. federal income tax purposes, as a partnership and not as an association or a publicly traded partnership taxable as a corporation. Class A shareholders may be subject to U.S. federal, state, local and possibly, in some cases, foreign income taxation on their allocable share of our items of income, gain, loss, deduction and credit (including our allocable share of those items of any entity in which we invest that is treated as a partnership or is otherwise subject to tax on a flow through basis) for each of our taxable years ending with or within their taxable year, regardless of whether or not they receive cash dividends from us. They may not receive cash dividends equal to their allocable share of our net taxable income or even the tax liability that results from that income. In addition, certain of our holdings, including holdings, if any, in a Controlled Foreign Corporation (CFC) and a Passive Foreign Investment Company (PFIC), may produce taxable income prior to the receipt of cash relating to such income, and holders of our Class A shares will be required to take such income into account in determining their taxable income. Under our operating agreement, in the event of an inadvertent partnership termination in which the Internal Revenue Service (IRS) has granted us limited relief, each holder of our Class A shares also is obligated to make such adjustments as are required by the IRS to maintain our status as a partnership. Such adjustments may require persons who hold our Class A shares to recognize additional amounts in income during the years in which they hold such shares. We may also be required to make payments to the IRS.

**Our intermediate holding company, FIG Corp., is subject to corporate income taxation in the United States, and we may be subject to additional taxation in the future.**

A significant portion of our investments and activities may be made or conducted through FIG Corp. Dividends paid by FIG Corp. from time to time will, as is usual in the case of a U.S. corporation, then be included in our income. Income received as a result of investments made or activities conducted through FIG Asset Co. LLC (but excluding through its taxable corporate affiliates) is not subject to corporate income

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

taxation in our structure, but we cannot provide any assurance that it will not become subject to additional taxation in the future, which would negatively impact our results of operations.

## **Table of Contents**

**There can be no assurance that amounts paid as dividends on Class A shares will be sufficient to cover the tax liability arising from ownership of Class A shares.**

Any dividends paid on Class A shares will not take into account a shareholder's particular tax situation (including the possible application of the alternative minimum tax) and, therefore, because of the foregoing as well as other possible reasons, may not be sufficient to pay their full amount of tax based upon their share of our net taxable income. In addition, the actual amount and timing of dividends will always be subject to the discretion of our board of directors. In particular, the amount and timing of dividends will depend upon a number of factors, including, among others:

our actual results of operations and financial condition;

restrictions imposed by our operating agreement or applicable law;

restrictions imposed by our credit agreements;

reinvestment of our capital;

the timing of the investment of our capital;

the amount of cash that is generated by our investments or to fund liquidity needs;

levels of operating and other expenses;

contingent liabilities; or

factors that our board of directors deems relevant.

Even if we do not distribute cash in an amount that is sufficient to fund a shareholder's tax liabilities, they will still be required to pay income taxes on their share of our taxable income.

**Tax gain or loss on disposition of our common units could be more or less than expected.**

If a Class A shareholder sells common units, such shareholder will recognize a gain or loss equal to the difference between the amount realized and the adjusted tax basis in those common units. Prior distributions to such common shareholder in excess of the total net taxable income allocated to such shareholder, which decreased the tax basis in its common units, will increase the gain recognized upon a sale when the common units are sold at a price greater than such shareholder's tax basis in those common units, even if the price is less than the original cost. A portion of the amount realized, whether or not representing gain, may be ordinary income to such shareholder.

**We currently do not intend to make an election under Section 754 of the Internal Revenue Code to adjust our asset basis, so a holder of common units could be allocated more taxable income in respect of those common units prior to disposition than if such an election were made.**

We currently do not intend to make an election under Section 754 of the Internal Revenue Code to adjust our asset basis. If no Section 754 election is made, there will generally be no adjustment to the basis of our assets in connection with our initial public offering, or upon a

## Edgar Filing: Fortress Investment Group LLC - Form 10-Q

subsequent transferee's acquisition of common units from a prior holder of such common units, even if the purchase price for those interests or units, as applicable, is greater than the share of the aggregate tax basis of our assets attributable to those interests or units immediately prior to the acquisition. Consequently, upon our sale of an asset, gain allocable to a holder of common units could include built-in gain in the asset existing at the time such holder acquired such units, which built-in gain would otherwise generally be eliminated if a Section 754 election had been made.

**If we are treated as a corporation for U.S. federal income tax purposes, the value of the Class A shares would be adversely affected.**

We have not requested, and do not plan to request, a ruling from the IRS on our treatment as a partnership for U.S. federal income tax purposes, or on any other matter affecting us. As of the date of the consummation of our initial public offering, under then current law and assuming full compliance with the terms of our operating agreement (and other relevant documents) and based upon factual statements and representations made by us, our outside counsel opined, as of that date, that we would be treated as a partnership, and not as an association or a publicly traded partnership taxable as a corporation for U.S. federal income tax purposes. However, opinions of counsel are not binding upon the IRS or any court, and the IRS may challenge this conclusion and a court may sustain such a challenge. The factual representations made by us upon which our outside counsel relied related to our organization, operation, assets, activities, income, and present and future conduct of our operations. In general, if an entity that would otherwise be classified as a partnership for U.S. federal income tax purposes is a publicly traded partnership (as defined in the Code) it will be nonetheless treated as a corporation for U.S. federal income tax purposes, unless the exception described below, and upon which we intend to rely, applies. A publicly traded partnership will, however, be treated as a partnership, and not as a corporation for U.S. federal income tax purposes, so long as 90% or more of its gross income for each taxable year constitutes qualifying income within the meaning of the Code and it is not required to register as an investment company under the Investment Company Act of 1940. We refer to this exception as the qualifying income exception.



---

**Table of Contents**

Qualifying income generally includes dividends, interest, capital gains from the sale or other disposition of stocks and securities and certain other forms of investment income. We expect that our income generally will consist of interest, dividends, capital gains and other types of qualifying income, including dividends from FIG Corp. and interest on indebtedness from FIG Corp. No assurance can be given as to the types of income that will be earned in any given year. If we fail to satisfy the qualifying income exception described above, items of income and deduction would not pass through to holders of the Class A shares and holders of the Class A shares would be treated for U.S. federal (and certain state and local) income tax purposes as shareholders in a corporation. In such a case, we would be required to pay income tax at regular corporate rates on all of our income. In addition, we would likely be liable for state and local income and/or franchise taxes on all of such income. Dividends to holders of the Class A shares would constitute ordinary dividend income taxable to such holders to the extent of our earnings and profits, and the payment of these dividends would not be deductible by us. Taxation of us as a publicly traded partnership taxable as a corporation could result in a material adverse effect on our cash flow and the after-tax returns for holders of Class A shares and thus could result in a substantial reduction in the value of the Class A shares.

**Our structure involves complex provisions of U.S. federal income tax law for which no clear precedent or authority may be available. Our structure also is subject to potential legislative, judicial or administrative change and differing interpretations, possibly on a retroactive basis.**

The U.S. federal income tax treatment of holders of the Class A shares depends in some instances on determinations of fact and interpretations of complex provisions of U.S. federal income tax law for which no clear precedent or authority may be available. Readers should be aware that the U.S. federal income tax rules are constantly under review by persons involved in the legislative process, the IRS, and the U.S. Treasury Department, frequently resulting in revised interpretations of established concepts, statutory changes, revisions to regulations and other modifications and interpretations. The IRS pays close attention to the proper application of tax laws to partnerships. The present U.S. federal income tax treatment of an investment in the Class A shares may be modified by administrative, legislative or judicial interpretation at any time, possibly on a retroactive basis, and any such action may affect investments and commitments previously made. For example, changes to the U.S. federal tax laws and interpretations thereof could make it more difficult or impossible to meet the qualifying income exception for us to be treated as a partnership for U.S. federal income tax purposes that is not taxable as a corporation, affect or cause us to change our investments and commitments, change the character or treatment of portions of our income (including, for instance, treating carried interest as ordinary fee income rather than capital gain) affect the tax considerations of an investment in us and adversely affect an investment in our Class A shares.

Our organizational documents and agreements permit the board of directors to modify our operating agreement from time to time, without the consent of the holders of Class A shares, in order to address certain changes in U.S. federal income tax regulations, legislation or interpretation. In some circumstances, such revisions could have a material adverse impact on some or all of the holders of our Class A shares. Moreover, we will apply certain assumptions and conventions in an attempt to comply with applicable rules and to report income, gain, deduction, loss and credit to holders in a manner that reflects such holders' beneficial ownership of partnership items, taking into account variation in ownership interests during each taxable year because of trading activity. However, these assumptions and conventions may not be in compliance with all aspects of applicable tax requirements. It is possible that the IRS will assert successfully that the conventions and assumptions used by us do not satisfy the technical requirements of the Code and/or Treasury regulations and could require that items of income, gain, deductions, loss or credit, including interest deductions, be adjusted, reallocated, or disallowed, in a manner that adversely affects holders of the Class A shares.

**We cannot match transferors and transferees of common units, and we have therefore adopted certain income tax accounting positions that may not conform with all aspects of applicable tax requirements. The IRS may challenge this treatment, which could adversely affect the value of our common units.**

Because we cannot match transferors and transferees of common units, we have adopted depreciation, amortization and other tax accounting positions that may not conform with all aspects of existing Treasury regulations. A successful IRS challenge to those positions could adversely affect the amount of tax benefits available to our common unitholders. It also could affect the timing of these tax benefits or the amount of gain on the sale of common units and could have a negative impact on the value of our common units or result in audits of and adjustments to our common unitholders' tax returns.

The sale or exchange of 50% or more of our capital and profit interests will result in the termination of our partnership for U.S. federal income tax purposes. We will be considered to have been terminated for U.S. federal income tax purposes if there is a sale or exchange of 50% or more of the total interests in our capital and profits within a 12-month period. Our termination would, among other things, result in the closing of our taxable year for all common unitholders and could result in a deferral of depreciation deductions allowable in computing our taxable income.

---

**Table of Contents**

**FIG Asset Co. LLC may not be able to invest in certain assets, other than through a taxable corporation.**

In certain circumstances, FIG Asset Co. LLC or one of its subsidiaries may have an opportunity to invest in certain assets through an entity that is characterized as a partnership for U.S. federal income tax purposes, where the income of such entity may not be qualifying income for purposes of the publicly traded partnership rules. In order to manage our affairs so that we will meet the qualifying income exception, we may either refrain from investing in such entities or, alternatively, we may structure our investment through an entity classified as a corporation for U.S. federal income tax purposes. If the entity were a U.S. corporation, it would be subject to U.S. federal income tax on its operating income, including any gain recognized on its disposal of its interest in the entity in which the opportunistic investment has been made, as the case may be, and such income taxes would reduce the return on that investment.

**Complying with certain tax-related requirements may cause us to forego otherwise attractive business or investment opportunities or enter into acquisitions, borrowings, financings or arrangements we may not have otherwise entered into.**

In order for us to be treated as a partnership for U.S. federal income tax purposes, and not as an association or publicly traded partnership taxable as a corporation, we must meet the qualifying income exception discussed above on a continuing basis and we must not be required to register as an investment company under the Investment Company Act of 1940. In order to effect such treatment we (or our subsidiaries) may be required to invest through foreign or domestic corporations, forego attractive business or investment opportunities or enter into borrowings or financings we may not have otherwise entered into. This may adversely affect our ability to operate solely to maximize our cash flow. Our structure also may impede our ability to engage in certain corporate acquisitive transactions because we generally intend to hold all of our assets through the Fortress Operating Group. In addition, we may be unable to participate in certain corporate reorganization transactions that would be tax free to our holders if we were a corporation. To the extent we hold assets other than through the Fortress Operating Group, we will make appropriate adjustments to the Fortress Operating Group agreements so that distributions to principals and us would be the same as if such assets were held at that level.

**The IRS could assert that we are engaged in a U.S. trade or business, with the result that some portion of our income is properly treated as effectively connected income with respect to non-U.S. holders. Moreover, certain REIT dividends and other stock gains may be treated as effectively connected income with respect to non-U.S. holders.**

While we expect that our method of operation will not result in a determination that we are engaged in a U.S. trade or business, there can be no assurance that the IRS will not assert successfully that we are engaged in a U.S. trade or business, with the result that some portion of our income is properly treated as effectively connected income with respect to non-U.S. holders. Moreover, dividends paid by an investment that we make in a REIT that is attributable to gains from the sale of U.S. real property interests will, and sales of certain investments in the stock of U.S. corporations owning significant U.S. real property may, be treated as effectively connected income with respect to non-U.S. holders. To the extent our income is treated as effectively connected income, non-U.S. holders generally would be subject to withholding tax on their allocable shares of such income, would be required to file a U.S. federal income tax return for such year reporting their allocable shares of income effectively connected with such trade or business, and would be subject to U.S. federal income tax at regular U.S. tax rates on any such income. Non-U.S. holders may also be subject to a 30% branch profits tax on such income in the hands of non-U.S. holders that are corporations.

**An investment in Class A shares will give rise to UBTI to certain tax-exempt holders.**

We will not make investments through taxable U.S. corporations solely for the purpose of limiting unrelated business taxable income, or UBTI, from debt-financed property and, thus, an investment in Class A shares will give rise to UBTI to certain tax-exempt holders. For example, FIG Asset Co. LLC will invest in or hold interests in entities that are treated as partnerships, or are otherwise subject to tax on a flow-through basis, that will incur indebtedness. FIG Asset Co. LLC may borrow funds from FIG Corp. or third parties from time to time to make investments. These investments will give rise to UBTI from debt-financed property. However, we expect to manage our activities to avoid a determination that we are engaged in a trade or business, thereby limiting the amount of UBTI that is realized by tax-exempt holders of our Class A shares.

**We may hold or acquire certain investments through an entity classified as a PFIC or CFC for U.S. federal income tax purposes.**

Certain of our investments may be in foreign corporations or may be acquired through a foreign subsidiary that would be classified as a corporation for U.S. federal income tax purposes. Such an entity may be a PFIC or a CFC for U.S. federal income tax purposes. U.S. holders of Class A shares indirectly owning an interest in a PFIC or a CFC may experience adverse U.S. tax consequences.

## **Table of Contents**

**Several items of tax legislation are currently being considered which, if enacted, could materially affect us, including by preventing us from continuing to qualify as a partnership for U.S. federal income tax purposes. Our structure also is subject to potential judicial or administrative change and differing interpretations, possibly on a retroactive basis.**

In December 2009, the U.S. House of Representatives passed H.R. 4213, the Tax Extenders Act of 2009. That proposed legislation contains a provision that, if enacted, would have the effect of treating income recognized from carried interests as ordinary income. While the proposed legislation, if enacted in its current form, would explicitly treat such income as nonqualifying income under the publicly traded partnership rules, thereby precluding us from qualifying for treatment as a partnership for U.S. federal income tax purposes, the proposed legislation provides for a 10-year transition period before such income would become nonqualifying income. In addition, the proposed legislation could, upon its enactment, prevent us from completing certain types of internal reorganization transactions on a tax free basis and acquiring other asset management companies on a tax free basis. The proposed legislation may also increase the ordinary income portion of any gain realized from the sale or other disposition of a Class A Share.

On March 2, 2009, Senator Carl Levin introduced the *Stop Tax Haven Abuse Act* in the United States Senate, similar to a prior legislative proposal from 2007. Among other effects, this proposal would, if enacted in its current form, subject our offshore funds to significant U.S. federal income taxes and potentially state and local taxes, which would adversely affect our ability to raise capital from foreign investors and certain tax-exempt investors.

As a result of widespread budget deficits, several states are evaluating proposals to subject partnerships to U.S federal or state entity level taxation through the imposition of state income, franchise or other forms of taxation. If any version of any of these legislative proposals were to be enacted into law in the form in which it was introduced, or if other similar legislation were enacted or any other change in the tax laws, rules, regulations or interpretations were to preclude us from qualifying for treatment as a partnership for U.S. federal income tax purposes under the publicly-traded partnership rules or otherwise impose additional taxes, Class A shareholders would be negatively impacted because we would incur a material increase in our tax liability as a public company from the date any such changes became applicable to us, which could result in a reduction in the value of our Class A Shares.

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

None.

### **Item 3. Defaults upon Senior Securities**

None.

### **Item 4. Reserved**

### **Item 5. Other Information**

None.

**Table of Contents**

**Item 6. Exhibits**

(a) and (c) Financial statements and schedules:  
See Part I, Item 1, Financial Statements

(b) Exhibits filed with this Quarterly Report on Form 10-Q:

- 3.1 Certificate of Formation of the Registrant (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 3.1).
- 3.2 Certificate of Amendment to Certificate of Formation of the Registrant (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 3.2).
- 3.3 Fourth Amended and Restated Limited Liability Company Agreement of the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 filed with the SEC on August 10, 2009 (File No. 001-33294), Exhibit 3.3).
- 10.1 Second Amendment to the Third Amended and Restated Credit Agreement, dated March 12, 2009, among FIG LLC, as Borrower, certain subsidiaries and affiliates of the Borrower, as Guarantors, the Lenders party thereto and L/C Issuer (incorporated by reference to the Registrant's Annual Report on Form 10-K filed with the SEC on March 16, 2009 (File No. 001-33294), Exhibit 10.31).
- 10.2 Third Amendment to the Third Amended and Restated Credit Agreement, dated March 13, 2009, among FIG LLC, as Borrower, certain subsidiaries and affiliates of the Borrower, as Guarantors, the Lenders party thereto and L/C Issuer (incorporated by reference to the Registrant's Annual Report on Form 10-K filed with the SEC on March 16, 2009 (File No. 001-33294), Exhibit 10.32).
- 10.3 Fourth Amendment to the Third Amended and Restated Credit Agreement, dated June 11, 2009, among FIG LLC, a Delaware limited liability company, certain subsidiaries and affiliates of the borrower, as guarantors, Bank of America, N.A., individually and as administrative agent and letter of credit issuer, Citibank, N.A., individually and as syndication agent, and the following commercial lending institutions: Deutsche Bank AG, New York Branch, Goldman Sachs Credit Partners, L.P., Lehman Commercial Paper Inc., Wells Fargo Bank, N.A., ING Capital LLC and JPMorgan Chase Bank, N.A. (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the SEC on June 17, 2009).
- 10.4 Amended and Restated Fortress Investment Group LLC 2007 Omnibus Equity Incentive Plan (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 filed with the SEC on August 10, 2009 (File No. 001-33294), Exhibit 10.4).
- 10.5 Employment, Non-Competition and Non-Solicitation Agreement, dated July 19, 2009, by and between Daniel H. Mudd and the Registrant (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the SEC on July 20, 2009).
- 10.6 Form of Indemnification Agreement, by and between Fortress Investment Group LLC and the executive officers and directors of the Registrant (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 filed with the SEC on August 10, 2009 (File No. 001-33294), Exhibit 10.6).
- 31.1 Certification of Chief Executive Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



**Table of Contents**

SIGNATURES

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

FORTRESS INVESTMENT GROUP LLC

August 9, 2010

By: /s/ Daniel H. Mudd  
Daniel H. Mudd  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Daniel N. Bass  
Daniel N. Bass  
Chief Financial Officer

August 9, 2010

By: /s/ Jonathan R. Brown  
Jonathan R. Brown  
Chief Accounting Officer

August 9, 2010