

Fortress International Group, Inc.  
Form 10-Q  
May 15, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2013

or

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

Commission file number: 000-51426

**FORTRESS INTERNATIONAL GROUP, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

**20-2027651**

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

**7226 Lee DeForest Drive, Suite 104**

**21046**

**Columbia, Maryland**

(Address of principal executive offices) (Zip Code)

**(410) 423-7300**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

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

**Common Stock, par value \$0.0001 per share, as of May 9, 2013**                      **14,712,508**

**FORTRESS INTERNATIONAL GROUP, INC.**

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**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements**

## FORTRESS INTERNATIONAL GROUP, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited)	
	March 31, 2013	December 31, 2012
Assets		
Current Assets		
Cash and cash equivalents	\$4,632,509	\$5,608,322
Contract and other receivables, net	12,564,772	7,525,340
Costs and estimated earnings in excess of billings on uncompleted contracts	900,295	813,348
Prepaid expenses and other current assets	480,048	429,089
Total current assets	18,577,624	14,376,099
Property and equipment, net	243,312	273,451
Goodwill	1,768,861	1,768,861
Other intangible assets, net	60,000	60,000
Other assets	21,792	19,358
Total assets	\$20,671,589	\$16,497,769
Liabilities and Stockholders' Equity		
Current Liabilities		
Convertible notes payable, current portion	\$500,000	\$500,000
Accounts payable and accrued expenses	11,283,658	5,753,347
Billings in excess of costs and estimated earnings on uncompleted contracts	1,720,349	3,028,627
Total current liabilities	13,504,007	9,281,974
Convertible notes, less current portion	1,832,301	1,957,301
Other liabilities	44,950	52,626
Total liabilities	15,381,258	11,291,901
Commitments and Contingencies	-	-
Stockholders' Equity		
Preferred stock- \$.0001 par value; 1,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock- \$.0001 par value, 49,000,000 and 100,000,000 shares authorized; 15,187,527 and 15,087,526 issued; 14,378,773 and 14,278,772 outstanding at March 31, 2013 and December 31, 2012, respectively	1,519	1,509
Additional paid-in capital	66,413,368	66,305,764
Treasury stock- 808,754 and 808,754 shares at cost at March 31, 2013 and December 31, 2012, respectively	(1,503,496 )	(1,503,496 )

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Accumulated deficit	(59,621,060)	(59,597,909 )
Total stockholders' equity	5,290,331	5,205,868
Total liabilities and stockholders' equity	\$20,671,589	\$16,497,769

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

## FORTRESS INTERNATIONAL GROUP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	(Unaudited)	
	For the Three Months Ended	
	March 31, 2013	March 31, 2012
Results of Operations:		
Revenue	\$ 14,118,627	\$ 14,309,861
Cost of revenue, excluding depreciation and amortization	11,358,976	12,255,359
Gross profit, excluding depreciation and amortization	2,759,651	2,054,502
Operating expenses:		
Selling, general and administrative	2,708,838	2,907,632
Restructuring charges	-	279,286
Depreciation and amortization	50,133	76,905
Total operating costs	2,758,971	3,263,823
Operating income (loss)	680	(1,209,321 )
Interest expense, net	(23,831 )	(42,768 )
Loss before income taxes	(23,151 )	(1,252,089 )
Income tax expense	-	-
Net loss	\$ (23,151 )	\$ (1,252,089 )
Basic Loss per Share:		
Loss per common share	\$ (0.00 )	\$ (0.09 )
Weighted average common shares outstanding	14,356,551	14,101,711
Diluted Loss per Share:		
Loss per common share	\$ (0.00 )	\$ (0.09 )
Weighted average common shares outstanding	14,356,551	14,101,711

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



## FORTRESS INTERNATIONAL GROUP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	(Unaudited)	
	For the Three Months Ended	
	March 31, 2013	March 31, 2012
Cash Flows from Operating Activities:		
Net loss	\$ (23,151 )	\$ (1,252,089 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	50,133	76,905
Stock-based compensation	107,614	139,034
Changes in operating assets and liabilities:		
Contracts and other receivables	(5,039,432 )	(3,996,775 )
Costs and estimated earnings in excess of billings on uncompleted contracts	(86,947 )	1,310,377
Prepaid expenses and other current assets	(50,959 )	(82,827 )
Other assets	(2,434 )	(3,118 )
Accounts payable and accrued expenses	5,530,311	3,336,379
Billings in excess of costs and estimated earnings on uncompleted contracts	(1,308,278 )	6,630
Other liabilities	(7,676 )	(1,290 )
Net cash used in operating activities	(830,819 )	(466,774 )
Cash Flows from Investing Activities:		
Purchase of property and equipment	(19,994 )	(222,413 )
Net cash used in investing activities	(19,994 )	(222,413 )
Cash Flows from Financing Activities:		
Payment on seller notes	(125,000 )	-
Purchase of treasury stock	-	(2,429 )
Net cash used in financing activities	(125,000 )	(2,429 )
Net decrease in cash	(975,813 )	(691,616 )
Cash, beginning of period	5,608,322	6,731,487
Cash, end of period	\$ 4,632,509	\$ 6,039,871
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 16,057	\$ 28,323
Cash paid for taxes	\$ 7,069	\$ 8,001

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

FORTRESS INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1)

**Basis of Presentation**

The unaudited condensed consolidated financial statements are as of March 31, 2013 and December 31, 2012 and for the three months ended March 31, 2013 and 2012 for Fortress International Group, Inc. (“Fortress” or the “Company” or “We”).

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and note disclosures normally included in the annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”), have been condensed or omitted pursuant to those rules and regulations. We recommend that you read these unaudited condensed consolidated financial statements in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2012, previously filed with the SEC. We believe that the unaudited condensed consolidated financial statements in this Quarterly Report on Form 10-Q reflect all adjustments that are necessary to fairly present the financial position, results of operations and cash flows for the interim periods presented. The results of operations for such interim periods are not necessarily indicative of the results that can be expected for the full year.

***Nature of Business and Organization***

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

The Company’s focus is centered on growing profitability and corresponding cash flow. On an ongoing basis, the Company works to increase sales, improve project utilization and align selling, general and administrative expenses with sales. In the first quarter of 2012, the Company implemented a restructuring plan with estimated total annual savings of \$2.8 million, of which \$1.4 million is an estimated reduction in selling, general and administrative expenses (see Note 3). We will continue to closely monitor our costs relative to actual and anticipated revenues and may make further reductions to selling, general and administrative expenses including but not limited to personnel and related costs and marketing.

During the first quarter of 2012, as a result of the decline in its profitability, the Company failed to comply with certain financial covenants under its revolving line of credit facility (Credit Agreement), which was then terminated June 28, 2012. At the time of termination of the Credit Agreement, the Company had no outstanding borrowings under the Credit Agreement. No penalties, fees, charges or assessments were due to the lender in connection with the termination of the Credit Agreement. The Company believes that the termination of the Credit Agreement will not have a material adverse effect on the Company's business, operating results, and financial condition.

The Company had \$4.6 million and \$5.6 million of unrestricted cash and cash equivalents at March 31, 2013 and December 31, 2012, respectively. During the three months ended March 31, 2013, the Company financed its operations through its cash balances and working capital. As a result of efforts to align and monitor operating costs with anticipated revenues, management believes that the Company's current cash and cash equivalents and expected future cash generated from operations will satisfy the expected working capital, capital expenditure and financial service requirements of the Company's current business through the next twelve months.

FORTRESS INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

***Recently Issued Accounting Pronouncements***

In May 2011, the FASB issued a new accounting standard on fair value measurements that clarifies the application of existing guidance and disclosure requirements, changes certain fair value measurement principles and requires additional disclosures about fair value measurements. We were required to adopt this standard in the first quarter of 2012. The adoption of this standard did not have a material impact on the Company's financial statements.

In September 2011, the FASB issued guidance that simplified how entities may test for goodwill impairment. This guidance permits entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform a two-step goodwill impairment test. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, and early adoption was permitted. This guidance did not have a material effect on the Company's financial statements.

In July 2012, the FASB issued guidance for testing impairment of indefinite-lived intangible assets. This guidance allows an organization the option of qualitatively assessing factors to determine if a quantitative impairment test of the indefinite-lived asset is necessary. If the qualitative assessment reveals that it is "more likely than not" that the indefinite-lived intangible asset is impaired, a calculation of the asset's fair value is required. This guidance is similar to ASU No. 2011-08 which changed the requirements for the assessment of an impairment to goodwill by allowing a "more likely than not" qualitative assessment of impairment before making detailed fair value calculations. This guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 and early adoption was permitted. This guidance did not have a material effect on our financial statements.

FORTRESS INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**(2) Accounts Receivable, net**

The Company had an allowance for doubtful accounts of \$0.04 million at March 31, 2013 and December 31, 2012. Bad debt expense was zero for the three months ended March 31, 2013 and 2012, respectively.

Included in accounts receivable was retainage associated with construction projects totaling \$0.3 million and \$0.2 million at March 31, 2013 and December 31, 2012, respectively.

The Company earned approximately 81% and 46% of its revenue from three and two customers for the three months ended March 31, 2013 and 2012, respectively. Accounts receivable from these three customers at March 31, 2013 and December 31, 2012 were \$10.6 million and \$3.7 million, respectively.

Under certain construction management contracts, the Company is obligated to obtain performance bonds with various financial institutions, which typically require a security interest in the corresponding receivable. At March 31, 2013 and December 31, 2012, bonds outstanding that are secured by specific project accounts receivable totaled \$25.8 million and \$18.5 million, respectively .

**(3) Accounts Payable, Accrued Expenses and Restructuring Liability**

The Company's accounts payable and accrued expenses were comprised of the following at:

	March 31, 2013	December 31, 2012
Accounts payable	\$ 3,797,076	\$ 2,022,893
Accounts payable retainage	433,015	462,983
Accrued project costs	5,985,348	2,386,713
Restructuring liability	9,845	54,141
Other accrued expenses	1,058,374	826,617
Total accounts payable and accrued expenses	\$ 11,283,658	\$ 5,753,347

In an effort to align the Company's resources with anticipated types of services and volume, the Company implemented a restructuring plan that included a reduction in force of 18 employees resulting in restructuring charges of \$0.3 million from accrued severance, equity based expense and health care costs for the three months ended March 31, 2012. No such charges were recorded in the current year.

**(4) Basic and Diluted Loss per Share**

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

	Three Months Ended March 31, 2013		2012			
	Loss	Shares	\$ per Share	Income		
<b>BASIC LOSS PER SHARE</b>						
Net (loss) income	\$(23,151)	14,356,551	\$(0.00)	\$(1,252,089)	14,101,711	\$(0.09)
<b>EFFECT OF DILUTIVE SECURITIES</b>						
Unvested restricted stock	-	-	-	-	-	-
Unsecured convertible note	-	-	-	-	-	-
<b>DILUTED (LOSS) EARNINGS PER SHARE</b>	<b>\$(23,151)</b>	<b>14,356,551</b>	<b>\$(0.00)</b>	<b>\$(1,252,089)</b>	<b>14,101,711</b>	<b>\$(0.09)</b>

The computation of diluted net loss per common share for the three months ended March 31, 2013 did not include 2.1 million shares underlying stock options, 193,336 shares of unvested restricted stock and unsecured promissory notes convertible into 312,010 shares of common stock outstanding at March 31, 2013, as their inclusion would be anti-dilutive. For the three quarters ended March 31, 2012, 490,002 shares of unvested restricted stock and unsecured promissory notes convertible into 366,666 shares of common stock that were outstanding at March 31, 2012 were not included.

FORTRESS INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(5)

**Employee Benefit Plans**

*Stock Compensation*

For the three months ended March 31, 2013 and March 31, 2012, the Company granted options to purchase 130,000 and zero shares, respectively, of our common stock.

For the three months ended March 31, 2013 and March 31, 2012, the Company granted 36,667 and 250,000 shares of restricted stock, respectively, under the 2006 Omnibus Incentive Compensation Plan.

For the three months ended March 31, 2013 and 2012, the Company recorded non-cash compensation expense included in selling, general and administrative expenses associated with vesting awards of \$0.1 million and \$0.1 million, respectively. At March 31, 2013, there was approximately \$0.8 million of unrecognized stock compensation with a weighted average remaining life of 2.2 years.

*Stock Options*

The Company has historically issued restricted stock; however, to further enable us to attract, retain and motivate key employees the Company for the first time issued options to purchase 2,100,000 shares of our common stock during the nine months ended September 30, 2012. The grants have various vesting features including ratably over three years on each anniversary from the grant date or they become exercisable on the condition that the fair market value of a share of the Company's common stock exceeds a set price for 20 consecutive trading days.

***Fair Value Determination*** -The Company utilized a Black-Scholes-Merton model to value stock options vesting over time, while market exercisable awards were valued using a Monte Carlo simulation. The Company will reconsider the use of the Black-Scholes-Merton model and Monte-Carlo simulation if additional information becomes available in the future that indicates another model would be more appropriate or if grants issued in future periods have characteristics that cannot be reasonably estimated under these models.

*Volatility* -The expected volatility of the options granted was estimated based upon historical volatility of the Company's share price through weekly observations of the Company's trading history corresponding to the expected term for Black-Scholes-Merton model and longest available history, or 6.69 years, for the Monte Carlo simulation.

*Expected Term* -Given the lack of historical experience, the expected term of options granted to employees was determined utilizing a plain vanilla approach whereby minimum or median time to vest and the contractual term of 10 years are averaged.

*Risk-free Interest Rate* -The yield was determined based on U.S. Treasury rates corresponding to the expected term of the underlying grants.

*Dividend Yield* -The Black-Scholes-Merton valuation model requires an expected dividend yield as an input. The Company does not anticipate paying dividends; therefore the yield was estimated at zero.

The following table summarizes weighted-average assumptions used in our calculations of fair value for the nine months ended March 31, 2013:

	Black-Scholes-Merton		Monte Carlo Simulation	
Volatility	95	%	95	%
Expected life of options (in years)	6		6	
Risk-free interest rate	1.02	%	1.66	%
Dividend yield	0	%	0	%

**(6) Common Stock Repurchases**

For the three months ended March 31, 2013, the Company did not repurchase any shares of common stock. For the three months ended March 31, 2012, the Company repurchased 21,647 shares with an aggregate value of \$0.02 million associated with the vesting of restricted stock held by an employee. Per terms of the restricted stock agreements, the Company paid the employee's related taxes associated with the employee's vested stock and decreased the shares held by the employee by a corresponding value, resulting in a share issuance net of taxes to the employee. The value of the shares netted for employee taxes represents treasury stock repurchased.



FORTRESS INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**(7) Income Taxes**

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

The Company is in a net operating loss carryover position. The net operating losses not utilized can be carried forward for 20 years to offset future taxable income. As of March 31, 2013 and December 31, 2012, a full valuation allowance has been recorded against the Company's deferred tax assets, as the Company has concluded that, under relevant accounting standards, it is more likely than not that the deferred tax assets will not be realizable.

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

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

The Company's prior federal and state income tax filings since 2009 remain open under statutes of limitation. Innovative Power System Inc.'s statutes of limitation are open from the 2009 tax year forward for both federal and Commonwealth of Virginia purposes. Quality Power Systems Inc.'s statutes of limitation are open from the 2009 tax year forward for both federal and Commonwealth of Virginia purposes. SMLB, Ltd. statutes of limitation are open from the 2009 tax year forward for both federal and State of Illinois purposes.

**(8) Notes Payable**

	March 31, 2012	December 31, 2012
Convertible, unsecured promissory note, due 2014 (4.0%)	\$ 2,332,301	\$ 2,457,301
Less current portion	500,000	500,000
Total debt, less current portion	\$ 1,832,301	\$ 1,957,301

For the three months ended March 31, 2013, the Company had and made payments totaling \$0.1 million.

On March 19, 2013, the Company and our President and Chief Operating Officer (“COO”) entered into a letter agreement that amended the convertible, unsecured promissory note issued to the COO in connection with the Company’s acquisition of VTC, L.L.C. and Vortech, LLC on January 19, 2007. The letter agreement extended the maturity date of the note from April 1, 2014 to July 1, 2014. All other provisions of the note remain in full force and effect, including that a regularly scheduled principal payment in the amount of \$125,000 is due and owing on April 1, 2014.

#### *Line of Credit*

On November 8, 2011, the Company and its subsidiaries Innovative Power Systems, Inc., VTC, L.L.C., Total Site Solutions Arizona, LLC, and Alletag Builders, Inc. (together with the Company, collectively, “Borrowers”) obtained a credit facility (the “Credit Facility”) from Wells Fargo Bank, National Association (“Lender”) pursuant to a Credit Agreement by and among Borrowers and Lender (the “Credit Agreement”). Borrowers’ obligations under the Credit Facility were joint and several. The maximum amount of the Credit Facility was \$2,000,000. The Credit Facility was subject to a borrowing base of 80% of eligible accounts receivable. Borrowings under the Credit Facility incurred interest at the London interbank offered rate plus 2.25% per annum. At December 31, 2011, there was no balance outstanding on the Credit Facility; however, the Company complied with its reporting and covenant requirements.

The Credit Facility would have matured on November 1, 2012; however, during the three months ended March 31, 2012, the Company failed to comply with the financial covenants requiring (a) a maximum ratio of total liabilities to tangible net worth as set forth in the Credit Agreement; and (b) a minimum debt service coverage ratio as set forth in the Credit Agreement. The Credit Facility was terminated effective June 28, 2012.

FORTRESS INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(9)

### Related Party Transactions

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

**S3 Integration, L.L.C.** (S3 Integration) is 15% owned by Thomas P. Rosato, the Company's former Chief Executive Officer, a former member of the Board of Directors, and the holder of approximately 12.2% of the Company's outstanding common stock. S3 Integration provides commercial security systems design and installation services as a subcontractor to the Company.

**Chesapeake Mission Critical, L.L.C.** (Chesapeake MC) is 10.32% owned by Mr. Rosato. Additionally, Chesapeake MC owes approximately \$0.5 million to Mr. Rosato. Additionally, Mr. Rosato is entitled to certain contingent payments not to exceed \$0.5 million in the event of a liquidation or sale of the business. Chesapeake MC is a manufacturers' representative reselling and servicing mechanical and electrical equipment from original equipment manufacturers.

**CTS Services, LLC** (CTS) is 9% owned by Mr. Rosato. CTS is a mechanical contractor that acts as a subcontractor to the Company for certain projects. In addition, CTS utilizes the Company as a subcontractor on projects as needed. Mr. Rosato also holds a note payable over ten years that has a balance of \$2.8 million at December 31, 2012. CTS is a mechanical and electrical contractor that specializes in commercial buildings and mission critical facilities.

**TPR Group Re Three, LLC** (TPR Group Re Three) is 50% owned by Mr. Rosato and Mr. Gallagher. TPR Group Re Three leases office space to the Company under the terms of a real property lease to TSS/Vortech. The original lease term expired at December 31, 2011. Prior to expiration, the lease was renegotiated to a full service lease, excluding utilities, at \$24 per square foot or an aggregate annual rate of \$0.3 million, representing an annual reduction of approximately \$0.2 million. The lease is cancellable by either the Company or TPR Group Re Three with six months written notice. The Company obtained an independent appraisal of the original lease, which determined the lease to be at fair value.

**RF Realty Investments, LLC (“RF Realty”)** is owned by Mr. Rosato and his family. RF Realty leases office and warehouse space to the Company. The Company obtained an independent appraisal of the lease, which determined the lease to be at fair value.

The following table sets forth transactions the Company has entered into with the above related parties for the three months ended March 31, 2013 and 2012. It should be noted that revenue represents amounts earned on contracts with related parties under which we provide services; and cost of revenue represents costs incurred in connection with related parties which provide services to us on contracts for our customers. As such a direct relationship to the revenue and cost of revenue information below by company should not be expected.

FORTRESS INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Revenue		
Chesapeake Mission Critical, LLC	\$ -	\$ -
Total	\$ -	\$ -
Cost of Revenue		
CTS Services, LLC	\$ 15,858	\$ -
S3 Integration, LLC	195	-
Total	\$ 16,053	\$ -
Selling, general and administrative		
Office rent paid on Chesapeake Tower SysteMS	38,378	-
Office rent paid to TPR Group Re Three, LLC	69,848	94,241
Total	\$ 108,226	\$ 94,241

	March 31, 2013	December 31, 2012
Accounts receivable/(payable):		
CTS Services, LLC	1,400	1,400
Chesapeake Mission Critical, LLC	-	-
Telco P&C, LLC	3,960	3,960
Total Accounts receivable	5,360	5,360
Total Accounts (payable)	-	-

**(10) Commitments, Contingencies and Other**

From time to time, we are involved in various legal matters and proceedings concerning matters arising in the ordinary course of business. The Company currently estimates that any ultimate liability arising out of these matters and proceedings will not have a material adverse effect on its financial position, results of operations, and cash flows.

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

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

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

### **Business Formation and Overview**

We were incorporated in Delaware on December 20, 2004 as a special purpose acquisition company formed under the name "Fortress America Acquisition Corporation" for the purpose of acquiring an operating business that performs services in the homeland security industry. On January 19, 2007, we acquired all of the outstanding membership interests of each of VTC, L.L.C., doing business as "Total Site Solutions" ("TSS"), and Vortech, L.L.C. ("Vortech" and, together with TSS, "TSS/Vortech") and simultaneously changed our name to "Fortress International Group, Inc." The acquisition fundamentally transformed the Company from a special purpose acquisition company to an operating business.

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

### ***Competition in Current Economic Environment***

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

We compete for business based upon our reputation, past experience, and our technical engineering knowledge of mission-critical facilities and their infrastructure. We believe our specialized technology service offerings that we deliver to our customers, our top secret clearances, and our turnkey suite of deliverables gives us a competitive advantage. We are developing and creating long term relationships with our customers because of our excellent reputation in the industry and will continue to create facility management relationships with our customers that we expect will provide us with steadier revenue streams to improve the value of our business. We believe these barriers and our technical capabilities and experience will differentiate us to compete with new entrants into the market or pricing pressures.

We closely monitor our proposal pricing and the volume of our contracts, but we cannot be certain that our current margins will be sustained. Furthermore, given the economic environment, to the extent the volume of our contracts further decreases, we may have to take additional measures to reduce our operating costs through additional reductions in general, administrative and marketing costs, including potential reductions in personnel and related costs.

***Contract Backlog***

We believe an indicator of our future performance is our backlog of uncompleted projects in process or recently awarded. Our backlog represents our estimate of anticipated revenue from executed and awarded contracts that have not been completed and that we expect will be recognized as revenues over the life of the contracts. The use of our backlog as an indicator of our future performance is limited because backlog does not include certain sources of revenue including any future renewals of facilities maintenance contracts, and the contracts underlying our backlog may be cancelled or modified on short notice which would affect the amount of backlog actually recognized as revenue. We have broken our backlog into the following three categories: (i) consulting engineering, consisting of services related to consulting and/or engineering design contracts, (ii) construction management, and (iii) facility management.

Backlog is not a measure defined in generally accepted accounting principles, and our methodology for determining backlog may not be comparable to the methodology of other companies in determining their backlog. Our backlog is generally recognized under two categories: (1) contracts for which work authorizations have been or are expected to be received on a fixed-price basis, guaranteed maximum price basis or time and materials basis, and (2) contracts awarded to us where some, but not all, of the work have not yet been authorized. At March 31, 2013, we had authorizations to proceed with work for approximately \$7.4 million, or 49% of our total backlog of \$15.1 million. At December 31, 2012, we had authorizations to proceed with work for approximately \$9.4 million, or 54% of our total backlog of \$17.3 million.

Approximately \$11.9 million, or 79%, and \$13.6 million, or 78%, of our backlog, relates to three customers at March 31, 2013 and December 31, 2012, respectively.

We believe that approximately 49% of the backlog at March 31, 2013 will be recognized during the next twelve months. The following table reflects the value of our backlog in the above three categories as of March 31, 2013 and December 31, 2012, respectively.

(In millions)

	March 31, 2013	December 31, 2012
Technology consulting	\$ 7.9	\$ 8.2
Construction management	1.2	3.3
Facilities management	6.0	5.8
Total	\$ 15.1	\$ 17.3



## **Critical Accounting Policies and Estimates**

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

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

### *Revenue Recognition*

We recognize revenue when pervasive evidence of an arrangement exists, the contract price is fixed or determinable, services have been rendered or goods delivered, and collectability is reasonably assured. Our revenue is derived from the following types of contractual arrangements: fixed-price contracts, time-and-materials contracts, cost-plus-fee contracts (including guaranteed maximum price contracts) and facility service and maintenance contracts. Our primary source of revenue is from fixed-price contracts and we apply ASC 605-35 Construction-Type and Production-Type Contracts, recognizing revenue on the percentage-of-completion method using costs incurred in relation to total estimated project costs.

Revenue from fixed price contracts is recognized on the percentage of completion method, measured by the percentage of total costs incurred to date to estimated total costs for each contract. This method is used because management considers cost incurred and costs to complete to be the best available measure of progress in the contracts. Contract costs include all direct materials, subcontract and labor costs and those indirect costs related to contract performance, such as indirect labor, payroll taxes, employee benefits and supplies.

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

Revenue on cost-plus-fee contracts is recognized to the extent of costs incurred, plus an estimate of the applicable fees earned. Fixed fees under cost-plus-fee contracts are recorded as earned in proportion to the allowable costs incurred in performance of the contract.

We may incur costs at risk subject to an executed contract document or change orders, whether approved or unapproved by the customer and/or claims related to certain contracts. Management determines the probability that such costs will be recovered based upon evidence such as engineering studies, past practices with the customer, specific discussions, correspondence or preliminary negotiations with our customer. We treat project costs as a cost of contract performance in the period incurred if it is not probable that the costs will be recovered or in the event of dispute, or we defer costs and/or recognize revenue up to the amount of the related cost if it is probable that the contract price will be adjusted and can be reliably estimated.

Billings in excess of costs and estimated earnings on uncompleted contracts are classified as current liabilities. Costs and estimated earnings in excess of billings, or work in process, are classified as current assets for the majority of the company's projects. Work in process on contracts is based on work performed but not yet billed to customers as per individual contract terms.

Certain of our contracts involve the delivery of multiple elements including design management, system installation and facilities maintenance. Revenues from contracts with multiple element arrangements are recognized as each element is earned based on the relative selling price of each element provided the delivered elements have value to customers on a standalone basis. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the service when it is sold separately or competitor prices for similar services.

Revenue and related costs for master and other service agreements billed on a time and materials basis are recognized as the services are rendered based on actual labor hours performed at contracted billable rates, and costs incurred on behalf of the customer. Services are also performed under master and other service agreements billed on a fixed fee basis. Under fixed fee master service and similar type service agreements for facilities and equipment, we furnish various unspecified units of service for a fixed price. These services agreements are recognized on the proportional performance method or ratably over the course of the service period and costs are recorded as incurred in performance.

### *Allowance for Doubtful Accounts*

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

### *Non-cash Compensation*

We apply the expense recognition provisions of ASC 718, *Compensation-Stock Compensation*. The recognition of the value of the instruments result in compensation or professional expenses in our financial statements. The expense differs from other compensation and professional expenses in that these charges are typically settled through the issuance of common stock, which would have a dilutive effect upon earnings per share, if and when restricted stock vests. The determination of the estimated fair value used to record the compensation or professional expenses associated with the equity or liability instruments issued requires management to make a number of assumptions and estimates that can change or fluctuate over time.

### *Goodwill and Other Purchased Intangible Assets*

Goodwill represents the excess of costs over fair value of net assets of businesses acquired. Other purchased intangible assets include the fair value of items such as customer contracts, backlog and customer relationships. SFAS No. 142, "Goodwill and Other Intangible Assets (SFAS No. 142)," establishes financial accounting and reporting for acquired goodwill and other intangible assets. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but rather tested for impairment on an annual basis or triggering event. Purchased intangible assets with a definite useful life are amortized on a straight-line basis over their estimated useful lives.

The estimated fair market value of identified intangible assets is amortized over the estimated useful life of the related intangible asset. We have a process pursuant to which we typically retain third-party valuation experts to assist us in determining the fair market values and useful lives of identified intangible assets. In interim periods, we evaluate these assets for impairment when events occur that suggest a possible impairment. Through the second quarter 2012, we experienced an other than temporary decline in the market value of our common shares. As a result of the decline during the interim period we evaluated the carrying value of goodwill and other long-lived intangible assets for impairment. Utilizing a third party firm we determined the carrying value of goodwill was in excess of the estimated fair value, resulting in an aggregate impairment on goodwill of approximately \$2.1 million during the year ended

December 31, 2012. At March 31, 2013,

the net carrying value of goodwill was \$1.8 million.

*Long-Lived Assets (Excluding Goodwill)*

In accordance with the provisions of ASC 360-10-35, *Impairment or Disposal of Long-Lived Assets* in accounting for long-lived assets such as property, equipment and intangible assets subject to amortization, we review the assets for impairment. If circumstances indicate the carrying value of the asset may not be fully recoverable, a loss is recognized at the time impairment exists and a permanent reduction in the carrying value of the asset is recorded. We believe that the carrying values of our long-lived assets of \$0.2 million as of March 31, 2013 are fully realizable.

### *Income Taxes*

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

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

We adopted ASC 740, *Income Taxes*, which prescribes a more-likely-than-not threshold of financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on de-recognition of income tax assets and liabilities, classification of current and deferred tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods and income tax disclosures. Management has concluded that the adoption of ASC 740 had no material effect on our financial position or results of operations. As of March 31, 2013, we do not have any material unrecognized tax benefit liabilities.

### ***Recently Issued Accounting Pronouncements***

In May 2011, the FASB issued a new accounting standard on fair value measurements that clarifies the application of existing guidance and disclosure requirements, changes certain fair value measurement principles and requires additional disclosures about fair value measurements. We were required to adopt this standard in the first quarter of 2012. The adoption of this standard did not have a material impact on our financial statements.

In September 2011, the FASB issued guidance that simplified how entities may test for goodwill impairment. This guidance permits entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform a two-step goodwill impairment test. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, and early adoption was permitted. This guidance did

not have a material effect on our financial statements.

In July 2012, the FASB issued guidance for testing impairment of indefinite-lived intangible assets. This guidance allows an organization the option of qualitatively assessing factors to determine if a quantitative impairment test of the indefinite-lived asset is necessary. If the qualitative assessment reveals that it is “more likely than not” that the indefinite-lived intangible asset is impaired, a calculation of the asset’s fair value is required. This guidance is similar to ASU No. 2011-08 which changed the requirements for the assessment of an impairment to goodwill by allowing a “more likely than not” qualitative assessment of impairment before making detailed fair value calculations. This guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 and early adoption was permitted. This guidance did not have a material effect on our financial statements.

**Results of operations for the three months ended March 31, 2013 compared with the three months ended March 31, 2012.**

*Revenue.* Revenue decreased \$0.2 million to \$14.1 million for the three months ended March 31, 2013 from \$14.3 million for the three months ended March 31, 2012. In the three months ended March 31, 2013, we completed a large facilities management project with revenue of \$5.0 million. In the three months ended March 31, 2012, we had a large construction management project in process with revenue of \$5.1 million recognized in that quarter.

*Cost of Revenue.* Cost of revenue decreased \$0.9 million to \$11.4 million for the three months ended March 31, 2013 from \$12.3 million for the three months ended March 31, 2012. The primary driver in the decrease to Cost of Revenue was an increase in facilities management projects which carry a higher gross margin than construction management projects. The large facilities management project noted above was not a factor in the increase in gross margin as it had a high composition of material.

*Gross Margin Percentage.* Gross margin percentage increased to 19.5% for the three months ended March 31, 2013 compared to 14.4% for the three months ended March 31, 2012. The increase in gross margin is attributable primarily to a change in the composition of work towards higher margin projects described above. The current gross margin percentage is consistent with anticipated gross margin levels given the composition of work, and we anticipate it to be in the 20% to 25% range for the remainder of the year.

*Selling, general and administrative expenses.* Selling, general and administrative expenses decreased \$0.2 million to \$2.7 million for the three months ended March 31, 2013 from \$2.9 million for the three months ended March 31, 2012. The decrease was primarily driven by \$0.2 million decrease in personnel savings from restructuring efforts.

*Restructuring charges.* Restructuring charges, consisting primarily of severance payments and equity based expense, decreased \$0.3 million to zero million for the three months ended March 31, 2013 from \$0.3 million for the three months ended March 31, 2012. In an effort to align our resources with anticipated types of services and volume, we implemented a restructuring plan with estimated annual savings of \$2.8 million of which \$1.4 million relates to selling, general and administrative expenses based on pay reductions, reductions in force of approximately 18 employees, and related reductions in employee benefits and other costs. We will continue to closely monitor our bookings and anticipated revenues, and we may take future actions to reduce operating costs associated with personnel and related costs to align with our sales in an effort to return to profitability.

*Depreciation.* Depreciation remained consistent at \$0.1 million for the three months ended March 31, 2013 compared to \$0.1 million for the three months ended March 31, 2012.

*Interest income (expense), net.* Our interest income (expense), net decreased to (\$23,831) for the three months ended March 31, 2013 compared to (\$42,768) for the three months ended March 31, 2012. The decrease in expense was primarily attributable to the paydown on the note payable to our COO (see Note 8).



**Financial Condition, Liquidity and Capital Resources**

	For the Three Months Ended March 31,		
	2013	2012	Change
Net loss	\$ (23,151	) \$ (1,252,089	) \$1,228,938
Adjustments to reconcile net (loss) income to net cash used in operations:			
Depreciation and amortization	50,133	76,905	(26,772 )
Stock and warrant-based compensation	107,614	139,034	(31,420 )
Net adjustments to reconcile net income for non-cash items	157,747	215,939	(58,192 )
Net change in working capital	(965,415	) 569,376	(1,534,791)
Cash used in operations	(830,819	) (466,774	) (364,045 )
Cash used in investing	(19,994	) (222,413	) 202,419
Cash used in financing	(125,000	) (2,429	) (122,571 )
Net decrease in cash	\$ (975,813	) \$ (691,616	) \$(284,197 )

*Operating Activity*

Net cash used in operating activities totaled \$0.8 million for the three months ended March 31, 2013 compared to \$0.5 million used in operating activities for the three months ended March 31, 2012. The \$0.4 million increase in operating cash outflows was attributable to a \$1.5 million increase in working capital, offset in part by a decrease in net loss of \$1.2 million. The increase in working capital was attributable primarily to projects at various stages of production in the first quarter 2013 compared to similar activity in the first quarter 2012.

*Investing Activity*

Net cash used in investing activities decreased \$0.2 million to \$0.0 million for the three months ended March 31, 2013 from approximately \$0.2 million used in for the three months ended March 31, 2012. The decrease was associated with a decrease in expenditures for leasehold improvements

*Financing Activity*

Net cash used in financing increased \$0.1 million for the three months ended March 31, 2013 from \$0.00 million for the three months ended March 31, 2012. For the three months ended March 31, 2013, financing activities consisted

primarily of the scheduled repayments under the note payable to our COO.

**Adjusted EBITDA**

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

	(Unaudited)	
	For the Three Months Ended	
	March 31, 2013	March 31, 2012
Net loss	\$ (23,151 )	\$ (1,252,089 )
Interest expense, net	23,831	42,768
Depreciation and amortization	50,133	76,905
EBITDA	\$ 50,813	\$ (1,132,416 )
Stock based compensation	107,614	97,367
Adjusted EBITDA	\$ 158,427	\$ (1,035,049 )

Adjusted EBITDA increased \$1.2 million to \$0.2 million in the three months ended March 31, 2013 from (\$1.0 million) for the three months ended March 31, 2012. The increase was primarily driven by increased gross profit for the three months ended March 31, 2013. Please refer to the preceding discussion within this “Results of Operations” section.

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

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

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

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

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

### *Liquidity and Capital Resources*

We had \$4.6 million and \$5.6 million of unrestricted cash and cash equivalents at March 31, 2013 and December 31, 2012, respectively. During the three months ended March 31, 2013, we have financed our operations primarily with cash on hand and working capital.

Our current corporate focus is centered on growing profitability and corresponding cash flow. During the three months ended March 31, 2013, our cash declined \$1.0 million, as a result of changes in working capital and their impact on operating cash flow. We work to monitor project utilization and align selling, general and administrative expenses through anticipated revenues. We are actively engaged in certain initiatives designed to expand our sales reach and presence, further develop our success in the modular data centers area and explore alternative s which capitalize on our expertise in design, build and managing critical mission programs.

During the first quarter of 2012, we completed implementation of an enhanced sales reporting tool, as we aim to increase sales productivity by realigning our sale focus and supporting productivity measures. Our efforts to maintain and grow profitability include closely monitoring our costs relative to actual and anticipated revenue, which may require us to make further reductions to operating costs.

During the first quarter 2012, as a result of the decline in profitability we failed to comply with certain financial covenants under our revolving line of credit facility, which was terminated effective June 28, 2012. At the time of covenant violation and subsequent termination of the credit agreement, we had no outstanding borrowings under the credit agreement and incurred no fees or penalties. We do not believe the termination of the credit agreement will have a material impact on our business, and the termination of our credit facility has not precluded us from obtaining bonds but may limit our total bonding capacity. We believe that our current cash and cash equivalents and expected future cash generated from operations will satisfy over the next twelve months the expected working capital, capital expenditure and financing obligations of our current business, including \$0.5 million in repayment of unsecured convertible promissory notes.

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

### *Off Balance Sheet Arrangements*

As of March 31, 2013, we do not have any off balance sheet arrangements.

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

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

**Item 4. Controls and Procedures.**

Our management performed an evaluation under the supervision and with the participation of our Chief Executive Officer (principal executive officer) and our Chief Financial Officer (principal financial officer) of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of March 31, 2013. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of March 31, 2013, our disclosure controls and procedures were effective.

**Changes in Internal Control over Financial Reporting**

There were no changes in the Company's internal control over financial reporting for the first quarter of 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting as such term is defined in Rule 13a-15 and 15d-15 of the Exchange Act of 1934, as amended.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

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

### **Item 1A. Risk Factors.**

In addition to the other information set forth in this Form 10-Q, you should carefully consider the factors discussed in Part I, “Item 1A: Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2012, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

This Quarterly Report on Form 10-Q and, in particular, our Management’s Discussion and Analysis of Financial Condition and Results of Operations set forth in Part I—Item 2 contain or incorporate a number of forward-looking statements. These forward-looking statements can be identified by the use of forward-looking terminology, including the words “believes,” “anticipates,” “plans,” “expects” and similar expressions that are intended to identify forward-looking statements. You should read such statements carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. There are a number of factors that could cause actual events or results to differ materially from those indicated by such forward-looking statements, many of which are beyond our control, including the factors set forth under “Item 1A. Risk Factors” of our 2012 Annual Report on Form 10-K

Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this Quarterly Report on Form 10-Q will be important in determining future

results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially. In addition, the forward-looking statements contained herein represent our estimate only as of the date of this filing and should not be relied upon as representing our estimate as of any subsequent date. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

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

Not applicable.

**Item 3. Defaults upon Senior Securities.**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information.**

Not applicable.



**Item 6. Exhibits.**

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

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

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

101.INS \*\* XBRL Instance Document

101.SCH \*\* XBRL Taxonomy Extension Schema

101.CAL \*\* XBRL Taxonomy Extension Calculation Linkbase

101.DEF \*\* XBRL Taxonomy Extension Definition Linkbase

101.LAB \*\* XBRL Taxonomy Extension Label Linkbase

101.PRE \*\* XBRL Taxonomy Extension Presentation Linkbase

\*

Filed herewith.

\*\*

Furnished herewith.

**SIGNATURES**

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

**FORTRESS INTERNATIONAL  
GROUP, INC.**

Date: May 15, 2013      By:    /s/ Anthony Angelini  
   Anthony Angelini  
   *Chief Executive Officer (Authorized  
   Officer  
   and Principal Executive Officer)*

Date: May 15, 2013 By: /s/ Kenneth D. Schwarz  
   Kenneth D. Schwarz  
   *Chief Financial Officer (Authorized Officer  
   and Principal Financial Officer)*