

Fortress Investment Group LLC  
Form 10-Q  
November 03, 2011  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2011

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)

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

**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)

**10105**

(Zip Code)

**(212) 798-6100**

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant 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   
(Do not check if a smaller reporting company)

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: 189,706,571 outstanding as of November 3, 2011.

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

Class B Shares: 305,857,751 outstanding as of November 3, 2011.

---

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

**FORM 10-Q**

**INDEX**

		<b>PAGE</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>		
<b><u>Item 1.</u></b>	<b><u>Financial Statements</u></b>	
	<u>Consolidated Balance Sheets as of September 30, 2011 (unaudited) and December 31, 2010</u>	1
	<u>Consolidated Statements of Operations (unaudited) for the three and nine months ended September 30, 2011 and 2010</u>	2
	<u>Consolidated Statement of Equity (unaudited) for the nine months ended September 30, 2011</u>	3
	<u>Consolidated Statements of Cash Flows (unaudited) for the nine months ended September 30, 2011 and 2010</u>	4
	<u>Notes to Consolidated Financial Statements (unaudited)</u>	5
	<u>Note 1</u> <u>Organization and Basis of Presentation</u>	5
	<u>Note 2</u> <u>Management Agreements and Fortress Funds</u>	8
	<u>Note 3</u> <u>Investments and Fair Value</u>	14
	<u>Note 4</u> <u>Debt Obligations</u>	19
	<u>Note 5</u> <u>Income Taxes and Tax Related Payments</u>	20
	<u>Note 6</u> <u>Related Party Transactions and Interests in Consolidated Subsidiaries</u>	21
	<u>Note 7</u> <u>Equity-Based and Other Compensation</u>	24
	<u>Note 8</u> <u>Earnings Per Share and Distributions</u>	26
	<u>Note 9</u> <u>Commitments and Contingencies</u>	29
	<u>Note 10</u> <u>Segment Reporting</u>	30
	<u>Note 11</u> <u>Subsequent Events</u>	36
	<u>Note 12</u> <u>Consolidating Financial Information</u>	36
<b><u>Item 2.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	40
	<u>Overview and Understanding the Asset Management Business</u>	40
	<u>Market Considerations</u>	45
	<u>Results of Operations</u>	48
	<u>Assets Under Management</u>	49
	<u>Performance of our Funds</u>	50
	<u>Liquidity and Capital Resources</u>	63
	<u>Critical Accounting Policies</u>	69
	<u>Contractual Obligations</u>	75
<b><u>Item 3.</u></b>	<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	76
<b><u>Item 4.</u></b>	<b><u>Controls and Procedures</u></b>	79

Table of Contents

**PART II. OTHER INFORMATION**

<u>Item 1.</u>	<u>Legal Proceedings</u>	80
<u>Item 1A.</u>	<u>Risk Factors</u>	80
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	110
<u>Item 3.</u>	<u>Defaults upon Senior Securities</u>	110
<u>Item 4.</u>	<u>(Removed and Reserved)</u>	110
<u>Item 5.</u>	<u>Other Information</u>	110
<u>Item 6.</u>	<u>Exhibits</u>	111
<u>SIGNATURES</u>		114

---

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

### 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 and certain advisory engagements which pay fees based on realizations (and on certain managed assets and, in some cases, a fixed fee); and
- (iv) the NAV or fair value 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, alternative asset companies and related managed accounts that are managed by the Fortress Operating Group. The Fortress Macro Fund is our flagship liquid hedge fund and the Drawbridge Special Opportunities Fund is our flagship credit hedge fund.

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

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.

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

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>.

The Company acknowledges that, notwithstanding the inclusion of the foregoing cautionary statements, it is responsible for considering whether additional specific disclosures of material information regarding material contractual provisions are required to make the statements in this report not misleading.

---

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

(dollars in thousands)

	September 30, 2011 (Unaudited)	December 31, 2010
<b>Assets</b>		
Cash and cash equivalents	\$ 313,738	\$ 210,632
Due from affiliates	215,823	303,043
Investments	1,061,460	1,012,883
Deferred tax asset	421,510	415,990
Other assets	96,776	134,147
	\$ 2,109,307	\$ 2,076,695
<b>Liabilities and Equity</b>		
<b>Liabilities</b>		
Accrued compensation and benefits	\$ 183,305	\$ 260,790
Due to affiliates	329,927	342,397
Deferred incentive income	260,673	198,363
Debt obligations payable	270,000	277,500
Other liabilities	97,620	68,230
	1,141,525	1,147,280
<b>Commitments and Contingencies</b>		
<b>Equity</b>		
Class A shares, no par value, 1,000,000,000 shares authorized, 189,706,571 and 169,536,968 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively		
Class B shares, no par value, 750,000,000 shares authorized, 305,857,751 and 300,273,852 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively		
Paid-in capital	1,837,651	1,465,358
Retained earnings (accumulated deficit)	(1,392,631)	(1,052,605)
Accumulated other comprehensive income (loss)	(581)	(1,289)
Total Fortress shareholders' equity	444,439	411,464
Principals' and others' interests in equity of consolidated subsidiaries	523,343	517,951
Total equity	\$ 967,782	\$ 929,415
	\$ 2,109,307	\$ 2,076,695

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

See notes to consolidated financial statements

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

(dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>Revenues</b>				
Management fees: affiliates	\$ 118,353	\$ 107,752	\$ 353,269	\$ 327,182
Management fees: non-affiliates	18,865	8,628	47,641	17,513
Incentive income: affiliates	14,754	7,487	44,361	53,892
Incentive income: non-affiliates	266	371	1,251	5,759
Expense reimbursements from affiliates	42,350	36,745	130,337	100,606
Other revenues (affiliate portion disclosed in Note 6)	1,071	1,242	5,433	8,791
	195,659	162,225	582,292	513,743
<b>Expenses</b>				
Interest expense	4,583	3,549	13,883	11,043
Compensation and benefits	158,426	184,107	535,259	523,029
Principals agreement compensation	279,623	239,975	751,749	712,101
General, administrative and other	34,165	26,620	109,545	71,970
Depreciation and amortization (including impairment - Note 2)	23,767	3,361	30,114	9,337
	500,564	457,612	1,440,550	1,327,480
<b>Other Income (Loss)</b>				
Gains (losses) (affiliate portion disclosed in Note 3)	(15,229)	2,025	(26,751)	(10,360)
Tax receivable agreement liability adjustment			(116)	1,317
Earnings (losses) from equity method investees	(64,483)	16,941	26,417	42,972
	(79,712)	18,966	(450)	33,929
<b>Income (Loss) Before Income Taxes</b>	<b>(384,617)</b>	<b>(276,421)</b>	<b>(858,708)</b>	<b>(779,808)</b>
Income tax benefit (expense)	2,712	4,545	(24,493)	(4,641)
<b>Net Income (Loss)</b>	<b>\$ (381,905)</b>	<b>\$ (271,876)</b>	<b>\$ (883,201)</b>	<b>\$ (784,449)</b>
<b>Principals and Others Interests in Income (Loss) of Consolidated Subsidiaries</b>	<b>\$ (239,847)</b>	<b>\$ (177,221)</b>	<b>\$ (543,175)</b>	<b>\$ (513,259)</b>
<b>Net Income (Loss) Attributable to Class A Shareholders</b>	<b>\$ (142,058)</b>	<b>\$ (94,655)</b>	<b>\$ (340,026)</b>	<b>\$ (271,190)</b>
<b>Dividends declared per Class A share</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Earnings Per Class A share</b>				
Net income (loss) per Class A share, basic	\$ (0.76)	\$ (0.57)	\$ (1.85)	\$ (1.70)
Net income (loss) per Class A share, diluted	\$ (0.83)	\$ (0.62)	\$ (1.88)	\$ (1.75)
Weighted average number of Class A shares outstanding, basic	190,006,987	168,907,106	185,373,605	163,920,012
Weighted average number of Class A shares outstanding, diluted	495,864,738	469,180,958	492,396,969	466,666,392

See notes to consolidated financial statements



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

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011

(dollars in thousands)

	Class A Shares	Class B Shares	Paid-In Capital	Retained Earnings (Accumulated Earnings Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Fortress Shareholders Equity	Principals and Others Interests in Equity of Subsidiaries	Total Equity
<b>Equity - December 31, 2010</b>	169,536,968	300,273,852	\$ 1,465,358	\$ (1,052,605)	\$ (1,289)	\$ 411,464	\$ 517,951	\$ 929,415
Contributions from principals and others interests in equity							71,902	71,902
Distributions to principals and others interests in equity			(397)			(397)	(92,973)	(93,370)
Conversion of Class B shares to Class A shares	4,749,434	(4,749,434)	3,878		(33)	3,845	(3,845)	
Net deferred tax effects resulting from acquisition and exchange of Fortress Operating Group units			9,093			9,093		9,093
Director restricted share grant	143,624		398			398	681	1,079
Capital increase related to equity-based compensation, net	15,276,545	10,333,333	346,095			346,095	584,455	930,550
Dilution impact of Class A share issuance			13,226		(89)	13,137	(13,137)	
Comprehensive income (loss) (net of tax)				(340,026)		(340,026)	(543,175)	(883,201)
Foreign currency translation					465	465	452	917
Comprehensive income (loss) from equity method investees					365	365	1,032	1,397
Total comprehensive income (loss)								(880,887)
<b>Equity - September 30, 2011</b>	189,706,571	305,857,751	\$ 1,837,651	\$ (1,392,631)	\$ (581)	\$ 444,439	\$ 523,343	\$ 967,782

See notes to consolidated financial statements

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

(dollars in thousands)

	<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash Flows From Operating Activities</b>		
Net income (loss)	\$ (883,201)	\$ (784,449)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities		
Depreciation and amortization	30,114	9,337
Other amortization and accretion	1,119	2,423
(Earnings) losses from equity method investees	(26,417)	(42,972)
Distributions of earnings from equity method investees	19,775	5,630
(Gains) losses	26,751	10,360
Deferred incentive income	(40,146)	(53,493)
Deferred tax (benefit) expense	2,924	391
Options received from affiliates	(12,615)	
Tax receivable agreement liability adjustment	116	(1,317)
Equity-based compensation, including Principals Agreement	930,869	881,200
Allowance for doubtful accounts	5,037	(2,303)
Other		(46)
Cash flows due to changes in		
Due from affiliates	(55,539)	(85,937)
Other assets	20,780	(5,076)
Accrued compensation and benefits	(19,835)	111,229
Due to affiliates	(9,601)	(9,009)
Deferred incentive income	99,239	146,281
Other liabilities	31,852	36,200
Net cash provided by (used in) operating activities	121,222	218,449
<b>Cash Flows From Investing Activities</b>		
Contributions to equity method investees	(69,923)	(48,857)
Distributions of capital from equity method investees	179,258	45,955
Purchase of fixed assets	(13,350)	(1,574)
Acquisitions, net of cash received		(13,474)
Net cash provided by (used in) investing activities	95,985	(17,950)
<b>Cash Flows From Financing Activities</b>		
Repayments of debt obligations	(7,500)	(41,925)
Principals and others interests in equity of consolidated subsidiaries - contributions	13,074	653
Principals and others interests in equity of consolidated subsidiaries - distributions	(119,675)	(122,602)
Net cash provided by (used in) financing activities	(114,101)	(163,874)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>103,106</b>	<b>36,625</b>
<b>Cash and Cash Equivalents, Beginning of Period</b>	<b>210,632</b>	<b>197,099</b>
<b>Cash and Cash Equivalents, End of Period</b>	<b>\$ 313,738</b>	<b>\$ 233,724</b>
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash paid during the period for interest	\$ 12,049	\$ 9,228
Cash paid during the period for income taxes	\$ 7,793	\$ 7,833
<b>Supplemental Schedule of Non-cash Investing and Financing Activities</b>		
Employee compensation invested directly in subsidiaries	\$ 58,865	\$ 70,124

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

Investments of receivable amounts into Fortress Funds	\$	143,800	\$	8,127
Dividends, dividend equivalents and Fortress Operating Group unit distributions declared but not yet paid	\$	2,805	\$	11,821
Distributions declared but not yet paid on other non-controlling interests	\$		\$	4,898
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)**

SEPTEMBER 30, 2011

(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 leading, highly diversified global investment 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, including related managed accounts (collectively, 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 asset-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. In addition, this segment includes a fund-of-funds business, which invests in Fortress Funds, funds managed by external managers, and direct investments.

3) Credit funds:

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

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 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 two Asia funds, a Japan real estate fund and an Asian investor based global opportunities fund.

4) Principal investments in the above described funds.

### ***Financial Statement Guide***

Selected Financial Statement Captions	Note Reference	Explanation
<b><u>Balance Sheet</u></b>		
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.

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

SEPTEMBER 30, 2011

(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 and one senior employee's ownership interests in Fortress Operating Group as well as employees' ownership interests in certain subsidiaries.
<b><u>Statement of Operations</u></b>		
Management Fees: Affiliates	2	Fees earned for managing Fortress Funds, generally determined based on the size of such funds.
Management Fees: Non-Affiliates	2	Fees earned from managed accounts and our traditional fixed income asset management business, generally determined based on the amount managed.
Incentive Income: Affiliates	2	Income earned from Fortress Funds, based on the performance of such funds.
Incentive Income: Non-Affiliates	2	Income earned from managed accounts, based on the performance of such accounts.
Compensation and Benefits	7	Includes equity-based, profit-sharing and other compensation to employees.
Principals Agreement Compensation	7	As a result of the principals agreement, the January 2007 value of a significant portion of the Principals' equity in Fortress is being recorded as an expense over an approximate 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)	3	The result of asset dispositions or changes in the fair value of investments or other financial instruments which are marked to market (including 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.

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

<b>Selected Financial Statement Captions</b>	<b>Note Reference</b>	<b>Explanation</b>
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.
<b>Other</b>		
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.

In May 2011, the FASB issued new guidance regarding the measurement and disclosure of fair value, which will become effective for Fortress on January 1, 2012. Fortress does not expect this guidance to have a material direct impact on its financial position, results of operations or liquidity. Fortress has not yet completed its assessment of the potential impact of this guidance on the fair values reported by its funds.

The FASB has recently issued or discussed a number of proposed standards on such topics as consolidation, the definition of an investment company, financial statement presentation, revenue recognition, leases, financial instruments, hedging, and contingencies. Some of the proposed changes are significant and could have a material impact on Fortress's reporting. Fortress has not yet fully evaluated the potential impact of these proposals, but will make such an evaluation as the standards are finalized.

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

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

for the year ended December 31, 2010 and notes thereto included in Fortress's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 1, 2011, as amended in Fortress's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 4, 2011. Capitalized terms used herein, and not otherwise defined, are defined in Fortress's consolidated financial statements for the year ended December 31, 2010.

Certain prior period amounts have been reclassified to conform to the current period's presentation.

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

**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 terms of agreements between Fortress and the Fortress Funds are generally determined in connection with third party fund investors.

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

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

Fortress recognized management fees and incentive income as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>Private Equity</b>				
<b>Private Equity Funds</b>				
Management fees - affil.	\$ 30,333	\$ 36,341	\$ 101,443	\$ 103,313
Incentive income - affil.	4,440	5,436	7,906	32,862
<b>Castles</b>				
Management fees - affil.	12,277	11,425	36,312	34,279
Management fees, options - affil.	5,594		12,615	
Management fees - non-affil.	1,668	579	3,606	1,953
Incentive income - affil.				
<b>Liquid Hedge Funds</b>				
Management fees - affil.	23,715	21,615	70,262	66,602
Management fees - non-affil.	4,223	2,879	13,598	5,883
Incentive income - affil.	239	671	2,299	399

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

Incentive income - non-affil.		371		985		371
<b>Credit Funds</b>						
<b>Credit Hedge Funds</b>						
Management fees - affil.	26,914		27,514		80,548	90,817
Management fees - non-affil.	8,004		262		15,573	1,074
Incentive income - affil.	34				2,182	
Incentive income - non-affil.						5,388
<b>Credit PE Funds</b>						
Management fees - affil.	19,520		10,857		52,089	32,171
Management fees - non-affil.	30				97	
Incentive income - affil.	10,041		1,380		31,974	20,631
Incentive income - non-affil.	266				266	
<b>Other (A)</b>						
Management fees - non-affil.	4,940		4,908		14,767	8,603
<b>Total</b>						
Management fees - affil.	\$ 118,353	\$	107,752	\$	353,269	\$ 327,182
Management fees - non-affil.	\$ 18,865	\$	8,628	\$	47,641	\$ 17,513
Incentive income - affil. (B)	\$ 14,754	\$	7,487	\$	44,361	\$ 53,892
Incentive income - non-affil.	\$ 266	\$	371	\$	1,251	\$ 5,759

(A) Related to Logan Circle.

(B) See Deferred Incentive Income below.

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

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 nine months ended September 30, 2011 and 2010. If the amount of incentive income contingent on achieving annual performance criteria was not contingent on the results of the subsequent quarters, \$46.1 million and \$69.4 million of additional incentive income from affiliates would have been recognized during the nine months ended September 30, 2011 and 2010, 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 nine months ended September 30, 2011 and 2010, Fortress recognized \$32.0 million and \$20.6 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 approximately 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 was comprised of the following, on an inception to date basis. This does not include any amounts related to third party funds, receipts from which are reflected as Other Liabilities until all contingencies are resolved.

	<b>Distributed- Gross</b>	<b>Distributed- Recognized (A)</b>	<b>Distributed- Unrecognized (B)</b>	<b>Undistributed net of intrinsic clawback (C) (D)</b>
Deferred incentive income as of December 31, 2010	\$ 702,709	\$ (504,346)	\$ 198,363	\$ 200,066

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

Share of income (loss) of Fortress Funds	N/A	N/A	N/A	119,026
Distribution of incentive income	102,456	N/A	102,456	(102,456)
Recognition of previously deferred incentive income	N/A	(40,146)	(40,146)	N/A
Deferred incentive income as of September 30, 2011	\$ 805,165	\$ (544,492)	\$ 260,673	\$ 216,636

---

(A) All related contingencies have been resolved.

(B) Reflected on the balance sheet.

(C) At September 30, 2011, the net undistributed incentive income is comprised of \$317.0 million of gross undistributed incentive income, net of \$100.4 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 September 30, 2011 at their net asset values.

(D) From inception to September 30, 2011, Fortress has paid \$331.7 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 individuals. If the \$317.0 million of gross undistributed incentive income were realized, Fortress would recognize and pay an additional \$121.2 million of compensation expense.

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

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(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 September 30, 2011:

Fund (Vintage) (A)	Maturity Date (B)	Inception to Date Capital Investment (C)	Inception to Date Distributions (C)	Net Asset Value (NAV) (D)	NAV Surplus (Deficit) (E)	Current Preferred Return Threshold (F)	Gain to Incentive Income Threshold (G)	Distributed Incentive Income (H)	Distributed Incentive Income Subject to Clawback (I)	Gross Intrinsic Clawback (J)	Net Intrinsic Clawback (J)
<b>Private Equity Funds</b>											
NIH (1998)	Indefinite	\$ 415,574	\$ (801,926)	\$ 16,950	\$ N/A	\$ N/A	\$ N/A	\$ 94,513	\$	\$	\$
Fund I (1999) (K)	Apr-10	1,027,871	(2,775,545)	94,595	1,842,269	N/A	17,837	329,042			
Fund II (2002)	Feb-13	1,974,296	(3,260,088)	86,502	1,372,294	N/A		287,024	43,184	17,003	10,886
Fund III (2004)	Jan-15	2,762,993	(1,317,108)	1,448,826	2,941	1,143,459	1,140,518	66,903	66,903	66,903	45,108
<b>Fund III Coinvestment (2004)</b>											
	Jan-15	273,648	(115,936)	153,399	(4,313)	146,571	150,884				
<b>Fund IV (2006) Coinvestment (2006)</b>											
	Jan-17	3,639,561	(126,308)	2,866,036	(647,217)	1,435,615	2,082,832				
<b>Fund V (2007) Coinvestment (2007)</b>											
	Jan-17	762,696	(12,651)	575,014	(175,031)	309,766	484,797				
	Feb-18	4,103,714	(7,102)	3,459,467	(637,145)	1,070,597	1,707,742				
<b>GAGACQ Fund (2004)</b>											
	Nov-09	545,663	(595,401)	N/A	N/A	N/A	N/A	51,476	N/A	N/A	N/A
FRID (2005)	Apr-15	1,220,228	(505,612)	311,018	(403,598)	550,296	953,894	16,447	16,447	16,447	10,041
FRIC (2006)	May-16	328,754	(17,460)	111,314	(199,980)	157,084	357,064				
FICO (2006)	Jan-17	724,525	(5)	(53,926)	(778,446)	325,914	1,104,360				
FHIF (2006)	Jan-17	1,508,484	(63,169)	1,999,959	554,644	595,558	40,914				
FECEI (2007)	Feb-18	982,779	(146)	841,560	(141,073)	367,625	508,698				
								\$ 17,837	\$ 845,405	\$ 126,534	\$ 100,353
								\$ 66,035			
<b>Private Equity Funds in Investment Period</b>											
WWTAI (2011)	Jun-24	12,600		10,471	(2,129)	213	2,342	\$	\$	\$	\$
<b>Credit PE Funds</b>											
<b>Long Dated Value Fund I (2005)</b>											
	Apr-30	\$ 267,325	\$ (46,931)	\$ 273,668	\$ 53,274	\$ 85,929	\$ 32,655	\$	\$	\$	\$
<b>Long Dated Value Fund II (2005)</b>											
	Nov-30	271,554	(100,966)	215,525	44,937	69,430	24,493	412			
<b>Long Dated Value Fund III (2007)</b>											
	Feb-32	340,740	(132,619)	290,849	82,728		N/A	12,353	2,998		
	Nov-27	38,591	(9,459)	51,612	22,480		N/A	1,571	461		

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

LDVF Patent Fund (2007)										
Real Assets Fund (2007)										
	Jun-17	358,460	(215,819)	220,225	77,584		N/A	9,741	2,360	
								\$ 23,665	\$ 6,231	\$ \$
<u>Credit PE Funds in Investment Period</u>										
Credit Opportunities Fund (2008)										
	Oct-20	\$ 4,855,787	\$ (4,751,916)	\$ 1,662,288	\$ 1,558,417	\$	N/A	\$ 97,509	\$ 208,487	\$ 102,854 \$
Credit Opportunities Fund II (2009)										
	Jul-22	1,532,549	(514,333)	1,242,016	223,800		N/A	37,733	6,089	278
Credit Opportunities Fund III (2011)										
	Mar-24	63,090		62,192	(898)		898			
FTS SIP L.P. (2008)										
	Oct-18	1,173,389	(982,360)	514,922	323,893		N/A	17,430	47,213	29,709
SIP Managed Account (2010)										
	Sep-20	11,000	(12,065)	7,336	8,401		N/A	1,834	266	
FCO MA LSS (2010)										
	Jun-24	151,157	(26,224)	131,340	6,407		N/A	338		
FCO MA II (2010)										
	Jun-22	345,628	(80,804)	311,589	46,765		N/A	7,499	1,376	
FCO MA Maple Leaf (2010)										
	Oct-20	192,152	(11,364)	176,402	(4,386)	7,198	11,584			
Assets Overflow Fund (2008)										
	May-18	90,500	(112,344)	1	21,845		N/A		2,180	1,298
Japan Opportunity Fund (2009)										
	Jun-19	1,086,540	(491,760)	795,269	200,489		N/A	30,113	8,674	
Net Lease Fund I (2010)										
	Feb-20	83,038	(6,545)	85,696	9,203		N/A	1,195		
Global Opportunities Fund (2010)										
	Sep-20	127,317	(14)	119,821	(7,482)	3,097	10,579			
Life Settlements Fund (2010)										
	Dec-22	285,441	(94,254)	168,367	(22,820)	14,937	37,757			
Life Settlements Fund MA (2010)										
	Dec-22	23,394	(7,696)	13,778	(1,920)	1,224	3,144			
Real Estate Opportunities Fund (2011)										
	Sep-24	15,238		14,712	(526)		526			
								\$ 193,651	\$ 274,285	\$ 134,139 \$

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

	Incentive Income Eligible NAV (L)	Gain to Cross Incentive Income Threshold (M)	Percentage of Incentive Income Eligible NAV Above Incentive Income Threshold (N)	Undistributed Incentive Income (O)	Year to date Incentive Income Crystallized (P)
<b>Liquid Hedge Funds</b>					
<u>Macro Funds (Q) (T)</u>					
Main fund investments	\$ 2,266,722	\$ 174,041	0.4%	\$ 65	\$ 720
Sidepocket investments (R)	49,798	31,765	N/A	780	
Sidepocket investments - redeemers (S)	254,909	154,256	N/A	3,982	
Managed accounts	559,874	40,313	0.0%		8
<u>Asia Macro Funds (T)</u>					
Main fund investments	188,434	8,737	0.0%		
<u>Fortress Commodities Funds</u>					
Main fund investments	874,614	6,206	59.1%	1,241	1,265
Managed accounts	150,000	2,505	0.0%		889
<u>Fortress Partners Funds (T)</u>					
Main fund investments	149,372	53,107	0.1%		
Sidepocket investments (R)	97,274	27,632	N/A	267	
<b>Credit Hedge Funds</b>					
<u>Special Opportunities Funds (T)</u>					
Main fund investments	\$ 3,021,516	\$ 330	97.9%	\$ 42,881	\$ 35
Sidepocket investments (R)	128,962	7,945	N/A	4,344	
Sidepocket investments - redeemers (S)	214,543	80,769	N/A	1,175	
Main fund investments (liquidating) (U)	1,481,502	163,451	88.9%	34,306	1,847
Managed accounts	28,823	20,342	0.0%		
<u>Worden Funds</u>					
Main fund investments	210,729	570	92.4%	1,981	
<u>Value Recovery Funds (V)</u>					
Managed accounts	77,556	5,606	68.0%	273	

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

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

- (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) Includes an increase to the NAV surplus related to the U.S. income tax expense of certain investment entities which is considered a distribution for the purposes of computing incentive income.
- (D) A NAV deficit 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). As of period end, there is an aggregate NAV surplus within both the private equity funds and credit PE funds.
- (E) Represents the gain needed to achieve the current relevant performance thresholds, assuming the gain described in (C) above is already achieved.
- (F) 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).
- (G) Represents the amount of additional incentive income Fortress would receive if the fund were liquidated at the end of the period at its NAV.
- (H) Represents the amount of incentive income previously received from the fund since inception.
- (I) 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 ).
- (J) 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 September 30, 2011, Fortress held \$44.6 million of such amounts on behalf of employees related to all of the private equity funds.
- (K) 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.

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

(L) Represents the portion of a fund's NAV or trading level that is eligible to earn incentive income.

(M) 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.

(N) 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 may vary, and may vary significantly. This percentage represents the performance of only the main fund investments and managed accounts relative to their respective incentive income thresholds. It does not incorporate the impact of unrealized losses on sidepocket investments that can reduce the amount of incentive income earned from certain funds. See footnote Q below.

(O) 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. For the Value Recovery Fund managed accounts, Fortress can earn incentive income if aggregate realizations exceed an agreed threshold. Main Fund Investments (Liquidating) pay incentive income only after all capital is returned.

(P) Represents the amount of incentive income Fortress has earned in the current period from the fund which is no longer subject to contingencies.

(Q) 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 September 30, 2011, as if they became realized, was immaterial to the amounts presented in the table for the Macro main fund.

(R) 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 and Fortress Partners 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 September 30, 2011, the undistributed incentive income from the Macro main fund would not be impacted.

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

(S) 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).

(T) Includes onshore and offshore funds.

(U) Relates to accounts where investors have provided return of capital notices and are subject to payout as underlying fund investments are realized.

(V) Excludes the Value Recovery Funds which had a NAV of \$664.7 million at September 30, 2011. Fortress began managing the third party originated Value Recovery Funds in June 2009 and does not expect to earn any incentive income from the fund investments.

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

During the nine months ended September 30, 2011, the capital commitment period of Fund V, Fund V Coinvestment and FECEI expired. At such time, the AUM for these funds were reduced in aggregate by approximately \$2.0 billion and, beginning in July 2011, these funds generate lower management fees.

During the nine months ended September 30, 2011, Fortress formed new private equity funds or credit PE funds which had capital commitments as follows as of September 30, 2011:

Fortress	\$	9,000
Fortress s affiliates		11,500
Third party investors		365,700
Total capital commitments	\$	386,200

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

During the nine months ended September 30, 2011, Fortress formed, or became the manager of, hedge funds with net asset values as follows as of September 30, 2011:

		<b>Liquid</b>
Fortress	\$	19,520
Fortress s affiliates		9,760
Third party investors		188,434
Total NAV (A)	\$	217,714

---

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

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

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

Nine Months Ended September 30,	Liquid Hedge Funds		Credit Hedge Funds	
	Redemption Notices Received	Redemptions Paid During the Period	Redemption Notices Received	Redemptions Paid During the Period
2011	\$ 1,256,317(A)	\$ 930,888	\$ 613,055(B)	\$ 752,023
2010	\$ 975,144	\$ 1,540,777	\$ 507,205(B)	\$ 964,783

(A) Consists of \$416.7 million related to funds subject to annual redemption and \$839.6 million subject to monthly or quarterly redemption, of which an aggregate of \$454.2 million was paid as of September 30, 2011.

(B) In October 2011 and 2010, Fortress's credit hedge funds received \$190.9 million and \$198.3 million of additional redemption requests, respectively.

The differences between notices received and redemptions paid are a result of timing (such as notices received prior to quarter end, paid afterwards), performance between the notice date and the payment date, and the contractual agreements regarding redemptions, which, in some cases, including all of the credit hedge funds, allow for delayed payment.

***Traditional Asset Management***

Logan Circle Partners, L.P. ( Logan Circle ) is a fixed income asset manager with approximately \$12.9 billion in assets under management as of September 30, 2011, which Fortress acquired in April 2010. 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.

Part of the acquisition price was paid with contingent consideration, which 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 \$4.0 million at closing (the actual payment will either be zero or between

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

\$5.3 million and \$28.0 million). The contingent consideration is measured at fair value (currently zero) 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).

The assets acquired primarily included goodwill and other intangible assets, which have been recorded in Other Assets. The intangible assets are being amortized over their estimated useful lives, which range from 1 to 8 years. Fortress tests 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 is estimated based on the following key assumptions (and therefore is considered a Level 3 valuation): expected retention rate of existing investors, growth expectations, estimated future fee rates, estimated operating margin, and market discount rates. These assumptions are determined primarily based on Logan Circle's past experience, Logan Circle's historical and recent investment performance, Logan Circle's business plans, current industry trends, and general economic expectations. These assumptions, particularly those relating to investor retention and growth expectations, as well as discount rates, are highly subjective and are subject to significant uncertainty with respect to future events. In the third quarter of 2011, Fortress determined that Logan Circle had not met certain growth targets in its business plan and therefore performed an intangible asset impairment test. As a result of this test, \$20.1 million of goodwill and other intangible assets was written off through Depreciation and Amortization.

During the nine months ended September 30, 2011, Logan Circle generated approximately \$14.8 million of revenues (primarily management fees from non-affiliates) and \$(14.0) million of net (loss). This net (loss) does not include the change in fair value of the contingent consideration or the write-off of goodwill and other intangible assets, but does include approximately \$4.2 million of allocated corporate overhead. 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 - see Note 7).

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

**3. INVESTMENTS AND FAIR VALUE**

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:

	<b>September 30, 2011</b>		<b>December 31, 2010</b>	
Equity method investees	\$	1,013,601	\$	949,410
Equity method investees, held at fair value		39,382		60,324
Total equity method investments		1,052,983		1,009,734
Options in equity method investees		8,477		3,149
Total investments	\$	1,061,460	\$	1,012,883

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

	<b>Three Months Ended September 30,</b>				<b>Nine Months Ended September 30,</b>			
	<b>2011</b>		<b>2010</b>		<b>2011</b>		<b>2010</b>	
Net realized gains (losses)	\$	(478)	\$	(637)	\$	(3,597)	\$	(292)
Net realized gains (losses) from affiliate investments		(221)		581		(518)		(601)
Net unrealized gains (losses)		1,495		(3,116)		2,873		(3,753)
Net unrealized gains (losses) from affiliate investments		(16,025)		5,197		(25,509)		(5,714)
Total gains (losses)	\$	(15,229)	\$	2,025	\$	(26,751)	\$	(10,360)

***Investments in Equity Method Investees***

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

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, 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		Fortress's Equity in Net Income (Loss)			
	September 30, 2011	December 31, 2010	Three Months Ended September 30,		Nine Months Ended September 30,	
			2011	2010	2011	2010
Private equity funds, excluding						
NIH (A)	\$ 651,844	\$ 611,794	\$ (57,160)	\$ 4,326	\$ 12,358	\$ 21,012
NIH	1,460	1,664	43	388	(57)	207
Newcastle (B)	4,175	6,872	N/A	N/A	N/A	N/A
Eurocastle (B)	81	2,184	N/A	N/A	N/A	N/A
Total private equity	657,560	622,514	(57,117)	4,714	12,301	21,219
Liquid hedge funds	203,409	197,792	(4,964)	6,159	3,747	12,500
Credit hedge funds	53,763	57,661	101	3,689	5,132	8,724
Credit PE funds	130,988	125,265	(2,133)	2,399	5,087	(1,537)
Other	7,263	6,502	(370)	(20)	150	2,066
	\$ 1,052,983	\$ 1,009,734	\$ (64,483)	\$ 16,941	\$ 26,417	\$ 42,972

(A) Includes Fortress's direct investments in the common stock of publicly traded private equity portfolio companies, primarily GAGFAH.

(B) Fortress elected to record these investments, as well as its direct investments in the common stock of publicly traded private equity portfolio companies, primarily GAGFAH, at fair value pursuant to the fair value option for financial instruments.

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

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

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

	Nine Months Ended September 30, 2011							Total
	NIH	Private Equity Other Funds (A)	Castles (B)	Liquid Hedge Funds	Credit Hedge Funds	PE Funds	Other	
Investment, beginning	\$ 1,664	\$ 611,794	\$ 9,056	\$ 197,792	\$ 57,661	\$ 125,265	\$ 6,502	\$ 1,009,734
Earnings from equity method investees	(57)	12,358	N/A	3,747	5,132	5,087	150	26,417
Other comprehensive income from equity method investees	(4)		N/A			2,299		2,295
Contributions to equity method investees		7,821		82,508	93,791	41,390	641	226,151
Distributions of earnings from equity method investees			N/A	(894)	(10,234)	(8,622)	(25)	(19,775)
Distributions of capital from equity method investees	(143)	(832)	N/A	(67,064)	(92,587)	(21,930)	(5)	(182,561)
Total distributions from equity method investees	(143)	(832)	N/A	(67,958)	(102,821)	(30,552)	(30)	(202,336)
Mark to fair value - during period (C)	N/A	(18,222)	(4,865)	N/A	N/A	N/A	N/A	(23,087)
Translation adjustment		1,856	65					1,921
Dispositions						(1,836)		(1,836)
Deconsolidation (D)				(12,680)		(10,665)		(23,345)
Reclassification to Due to Affiliates (E)		37,069						37,069
Investment, ending	\$ 1,460	\$ 651,844	\$ 4,256	\$ 203,409	\$ 53,763	\$ 130,988	\$ 7,263	\$ 1,052,983
Ending balance of undistributed earnings	\$	\$ 25,435	N/A	\$ 110	\$ 4,774	\$ 2,637	\$ 2,054	\$ 35,010

(A) Includes Fortress's direct investments in the common stock of publicly traded private equity portfolio companies, primarily GAGFAH.

(B) Fortress elected to record these investments, as well as its direct investment in the common stock of publicly traded private equity portfolio companies, primarily GAGFAH, at fair value pursuant to the fair value option for financial instruments.

(C) Recorded to Gains (Losses).

(D) Represents the deconsolidation of two funds discussed under Investments in Variable Interest Entities below.

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

(E) Represents the general partner liability discussed in Note 9.

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.

	Private Equity Funds excluding NIH	
	September 30, 2011	December 31, 2010
Assets	\$ 13,025,455	\$ 12,490,411
Debt	(43,377)	(145,043)
Other liabilities	(239,266)	(197,587)
Equity	\$ 12,742,812	\$ 12,147,781
Fortress' s Investment (A)	\$ 651,844	\$ 611,794
Ownership (B)	5.1%	5.0%

	Nine Months Ended September 30,	
	2011	2010
Revenues and gains (losses) on investments	\$ 849,622	\$ 705,106
Expenses	(195,974)	(172,722)
Net Income (Loss)	\$ 653,648	\$ 532,384
Fortress' s equity in net income (loss)	\$ 12,358	\$ 21,012

---

(A) Includes Fortress' s direct investments in the common stock of publicly traded private equity portfolio companies, primarily GAGFAH. These companies' summary financial information is not included in this table.

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

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

	Liquid Hedge Funds		Credit Hedge Funds		Credit PE Funds (B) (C)	
	September 30, 2011	December 31, 2010	September 30, 2011	December 31, 2010	September 30, 2011	December 31, 2010
Assets	\$ 8,345,349	\$ 7,418,362	\$ 8,822,057	\$ 9,579,405	\$ 6,990,532	\$ 6,593,935
Debt		(11,898)	(3,144,624)	(3,475,675)	(82,083)	(358,095)
Other liabilities	(2,196,770)	(1,299,246)	(158,244)	(590,845)	(491,869)	(573,000)
Non-controlling interest			(8,647)	(15,647)	(1,721)	(4,945)
Equity	\$ 6,148,579	\$ 6,107,218	\$ 5,510,542	\$ 5,497,238	\$ 6,414,859	\$ 5,657,895
Fortress s Investment	\$ 203,409	\$ 197,792	\$ 53,763	\$ 57,661	\$ 130,988	\$ 125,265
Ownership (A)	3.3%	3.2%	1.0%	1.0%	2.0%	2.2%

	Nine Months Ended September 30, 2011		Nine Months Ended September 30, 2010		Nine Months Ended September 30, 2011		Nine Months Ended September 30, 2010	
	Revenues and gains							
(losses) on investments	\$ (78,441)	\$ 425,212	\$ 564,429	\$ 988,362	\$ 447,707	\$ 871,615		
Expenses	(163,415)	(129,613)	(195,722)	(198,613)	(170,347)	(214,131)		
Net Income (Loss)	\$ (241,856)	\$ 295,599	\$ 368,707	\$ 789,749	\$ 277,360	\$ 657,484		
Fortress s equity in net income (loss)	\$ 3,747	\$ 12,500	\$ 5,132	\$ 8,724	\$ 5,087	\$ (1,537)		

(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, 2011 and 2010, respectively) and several 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.

(C) Includes certain entities in which Fortress has both a direct and an indirect investment.

*Investments in Variable Interest Entities*

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

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, except as described below. No reconsideration events occurred during the nine months ended September 30, 2011 which caused a change in Fortress's accounting, except as described below.

The following tables set forth certain information as of September 30, 2011 regarding variable interest entities 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.

Entities formed during the nine months ended September 30, 2011:

Business Segment	Gross Assets	Fortress is not Primary Beneficiary		Notes
		Financial Obligations (A)	Fortress Investment (B)	
Credit PE Funds	\$ 229,111	\$	\$ 2,426	(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.

(B) Represents Fortress's maximum exposure to loss with respect to these entities, which includes direct and indirect investments in these funds, plus any receivables due from these 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 those entities.

(C) Fortress is not the primary beneficiary of these entities, which primarily represent investing vehicles, because the related funds (which are not consolidated) are more closely associated with these entities than Fortress based on both a quantitative and qualitative analysis. The investing vehicles were formed for the sole purpose of acting as investment vehicles for the related funds.

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

All variable interest entities:

Business Segment	Gross Assets	Fortress is not Primary Beneficiary			Gross Assets	December 31, 2010 Financial Obligations (A)	Fortress Investment (B)	Notes
		September 30, 2011 Financial Obligations (A)	Fortress Investment (B)	September 30, 2011 Financial Obligations (A)				
Private Equity Funds	\$ 17,168	\$	\$ 1,460	\$ 329,999	\$ 189,738	\$ 1,974	(C) (D)	
Castles	7,595,706	6,759,687	19,061	10,183,554	9,944,424	19,122	(C) (D)	
Liquid Hedge Funds	5,923,743	1,623,092	13,105	4,217,992	722,194	43,948	(C) (D)	
Credit Hedge Funds	1,531,785	346,671	17,823	1,404,971	378,768	38,461	(C) (D)	
Credit PE Funds	560,847	58,581	4,462	930,513	450,530	1,962	(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.

(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 entities 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) Fortress's investment includes management fees receivable, incentive income receivable, expense reimbursements and other receivables from these entities, as applicable.

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. As a result of this reconsideration

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

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, was deemed to be its primary beneficiary. Therefore, Fortress consolidated FCF beginning in March 2010. As of September 30, 2011, FCF's gross assets were approximately \$56.1 million, primarily comprised of affiliate receivables. Fortress's exposure to loss from FCF is limited to its unreserved outstanding advances, which were approximately \$30.7 million at September 30, 2011, 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 and FCF's assets are not available to other creditors of Fortress.

In March 2011, Fortress launched a liquid hedge fund and a related onshore feeder fund, which is a VIE. The onshore feeder fund invests substantially all of its equity directly into the liquid hedge fund. Based on a quantitative and qualitative analysis, management determined that Fortress was originally the entity that was most closely associated with the onshore feeder fund. Therefore, Fortress was the onshore feeder fund's primary beneficiary and consolidated it. On July 1, 2011, additional investors made cash contributions to the onshore feeder fund causing Fortress to reconsider whether Fortress remained the entity that is most closely associated with the onshore feeder fund. Based on a qualitative and quantitative analysis, management has determined that Fortress ceased to be the entity most closely associated with the onshore feeder fund. Therefore, Fortress derecognized the onshore feeder fund's gross assets and non-controlling interests therein and recognized a corresponding equity investment representing Fortress's proportionate share of the onshore feeder fund. Fortress did not recognize any gain or loss as the result of its deconsolidation of the onshore feeder fund, but Fortress has begun to recognize management fees and incentive income, if any, earned from the onshore feeder fund in its consolidated statement of operations.

In June 2011, Fortress launched a credit PE fund, which is a VIE. Based on a quantitative and qualitative analysis, management has determined that Fortress was originally the entity that was most closely associated with the fund. Therefore, Fortress was the fund's primary beneficiary and consolidated it. In September 2011, additional investors made cash contributions to this fund causing Fortress to reconsider whether Fortress remained the entity that is most closely associated with this fund. Based on a qualitative and quantitative analysis, management determined that Fortress ceased to be the entity most closely associated with this fund. Therefore, Fortress derecognized this fund's gross assets and non-controlling interests therein and recognized a corresponding equity investment representing Fortress's proportionate share

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

of this fund. Fortress didn't recognize any gain or loss as the result of its deconsolidation of this fund, but Fortress has begun to recognize management fees and incentive income, if any, earned from this fund.

***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).

	Fair Value		Valuation Method
	September 30, 2011	December 31, 2010	
<b>Assets (within Investments)</b>			
Newcastle and Eurocastle common shares	\$ 4,256	\$ 7,222	Level 1 - Quoted prices in active markets for identical assets
Common stock of publicly traded private equity portfolio companies, primarily GAGFAH	\$ 35,127	\$ 51,267	Level 1 - Quoted prices in active markets for identical assets
Eurocastle convertible debt (A)	\$	\$ 1,834	Level 3 - Binomial lattice-based option valuation models, adjusted for non-option characteristics
Newcastle and Eurocastle options	\$ 8,477	\$ 3,149	Level 2 - Lattice-based option valuation models using significant observable inputs
<b>Assets (within Other Assets)</b>			
Derivatives	\$ 1,040	\$ (2,732)	Level 2 - See below
<b>Liabilities (within Other Liabilities)</b>			
Logan Circle Contingent Consideration	\$	\$ (3,122)	Level 3 - Internal model using significant unobservable inputs

(A) The debt bears interest at 20% per annum and is perpetual, but Eurocastle may redeem the securities after June 2011 at a premium of 20%. As of September 30, 2011, it had a face amount of 1.2 million (\$1.6 million) and was convertible into Eurocastle common shares at 0.30 per share. The fair value was determined using the market value approach.

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

Fortress' s interests in instruments measured at fair value using Level 3 inputs changed during the nine months ended September 30, 2011 as follows:

	<b>Assets</b>		<b>Liabilities</b>	
Balance at December 31, 2010	\$	1,834	\$	(3,122)
Total gains (losses) included in net income (including foreign currency translation)		(1,834)		3,122
Balance at September 30, 2011	\$		\$	

See Note 4 regarding the fair value of Fortress' s outstanding debt.

In March 2011, Newcastle issued 17.3 million shares of its common stock in a public offering at a price to the public of \$6.00 per share. For the purposes of compensating Fortress for its successful efforts in raising capital for Newcastle, in connection with this offering, Newcastle granted options to Fortress to purchase 1,725,000 shares of Newcastle' s common stock at the public offering price, which were valued at approximately \$7.0 million. The options were fully vested upon issuance, become exercisable over thirty months and have a 10-year term.

In September 2011, Newcastle issued 25.9 million shares of its common stock in a public offering at a price to the public of \$4.55 per share. For the purposes of compensating Fortress for its successful efforts in raising capital for Newcastle, in connection with this offering, Newcastle granted options to Fortress to purchase 2,587,500 shares of Newcastle' s common stock at the public offering price, which were valued at approximately \$5.6 million. The options were fully vested upon issuance, become exercisable over thirty months and have a 10-year term.

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

*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 and options to economically hedge the risk of fluctuations in foreign exchange rates with respect to certain foreign currency denominated assets. Gains and losses on these contracts are reported currently in Gains (Losses).

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.

Fortress's derivatives (not designated as hedges) are recorded as follows:

	Balance Sheet Location (A)	Fair Value September 30, 2011	Notional Amount September 30, 2011	Gains/(Losses) Nine Months Ended September 30, 2011	Maturity Date
Foreign exchange option contract	Other Assets	\$ 1,457	30,000	\$ (57)	Feb-12
Foreign exchange option contract	Other Assets	\$ (417)	30,000	\$ 655	Feb-12

(A) Fortress has a master netting agreement with its counterparty.

The counterparty on these derivatives is Citibank N.A.

**4. DEBT OBLIGATIONS**

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

Debt Obligation	Face Amount and Carrying Value		Contractual Interest Rate	Final Stated Maturity	September 30, 2011	
	September 30, 2011	December 31, 2010			Weighted Average Funding Cost (A)	Weighted Average Maturity (Years)
<b>Credit agreement (B)</b>						
Revolving debt (C)	\$	\$	LIBOR + 4.00% (D)	Oct-13		
Term loan	270,000	277,500	LIBOR + 4.00% (D)	Oct-15	6.09%	3.04
<b>Total</b>	<b>\$ 270,000</b>	<b>\$ 277,500</b>			<b>6.09%</b>	<b>3.04</b>

(A) The weighted average funding cost is calculated based on the contractual interest rate (utilizing the most recently reset LIBOR rate or the minimum rate, as applicable) plus the amortization of deferred financing costs. The most recently reset LIBOR rate was below the minimum of 1.75%.

(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 \$53.9 million was undrawn on the revolving debt facility as of September 30, 2011. The revolving debt facility includes a \$25 million letter of credit subfacility of which \$6.1 million was utilized.

(D) With a minimum LIBOR rate of 1.75% and, in the case of the revolving debt, subject to unused commitment fees of 0.625% 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 its face amount at September 30, 2011.

Fortress was in compliance with all of its debt covenants as of September 30, 2011. The following table sets forth the financial covenant requirements as of September 30, 2011.

	September 30, 2011 (dollars in millions)		Notes
	Requirement	Actual	
AUM, as defined	≥ \$25,000	\$ 35,010	(A)
Consolidated Leverage Ratio	≤ 2.75	0.69	(B)
Minimum Investment Assets Ratio	≥ 2.00	4.35	(C)
Consolidated Fixed Charge Coverage Ratio	≥ 1.75	4.63	(B)

(A) Impacted by capital raised in funds, redemptions from funds, and valuations of fund investments. The AUM presented here is based on the definition in the credit agreement.

(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)**

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

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

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.

Fortress recognizes compensation expense from the issuance of RSUs and RPU's over their vesting period. Consequently, Fortress records an estimated income tax benefit associated with RSUs and RPU's. However, Fortress is not entitled to an actual deduction on its income tax returns until a later date when the compensation is considered taxable to the employee. The actual income tax deduction can vary significantly from the amount recorded as an income tax benefit in earlier periods and is based on the value of the stock at the date the compensation is taxable to the employee.

At each tax deduction date, Fortress is required to compare the amount of the actual income tax benefit to the estimated amount recognized earlier. If the actual tax benefit is less than that estimated, which will occur if the price of the stock has declined during the vesting period, Fortress has a tax shortfall. The tax shortfall must be charged to income tax expense to the extent Fortress does not have prior excess tax benefits (i.e., prior actual tax benefits associated with RSUs and RPU's that were greater than the estimated benefits).

Based on the value of the RSUs and RPU's which vested during the nine months ended September 30, 2011, Fortress has estimated a \$26.8 million tax shortfall which was charged to income tax expense during this period.

The provision for income taxes consists of the following:

Current	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Federal income tax expense (benefit)	\$ 9,565	\$ (3,134)	\$ 14,398	\$ (505)
Foreign income tax expense (benefit)	1,350	631	5,111	1,723
State and local income tax expense (benefit)	(950)	6	2,060	3,032

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

	9,965	(2,497)	21,569	4,250
<b>Deferred</b>				
Federal income tax expense (benefit)	(12,436)	(3,047)	(1,035)	(2,518)
Foreign income tax expense (benefit)	1	14	239	45
State and local income tax expense (benefit)	(242)	985	3,720	2,864
	(12,677)	(2,048)	2,924	391
Total expense (benefit)	\$ (2,712)	\$ (4,545)	\$ 24,493	\$ 4,641

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

	September 30, 2011	December 31, 2010
Total deferred tax assets	\$ 528,762	\$ 512,201
Valuation allowance	(107,252)	(96,211)
Net deferred tax assets	\$ 421,510	\$ 415,990
Total deferred tax liabilities (A)	\$ 495	\$ 495

(A) Included in Other Liabilities

For the nine months ended September 30, 2011, a deferred income tax expense of \$0.3 million was debited to other comprehensive income, primarily related to the equity method investees. A current income tax benefit of \$0.7 million was credited to paid-in capital, related to (i) dividend equivalent payments on RSUs and RPU's (Note 8), as applicable, and (ii) distributions to Fortress Operating Group restricted partnership unit holders (Note 8), which are currently deductible for income tax purposes.

FIG Corp increased its ownership in the underlying Fortress Operating Group entities during the nine months ended September 30, 2011 through (i) the exchanges by one senior employee of Fortress Operating Group units and Class B

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

shares for Class A shares (as described in Note 8), and (ii) the delivery of vested RSUs and RPU's (Note 8). As a result of this increased ownership, the deferred tax asset was increased by \$7.1 million with an offsetting increase of \$2.7 million to the valuation allowance. In addition, the deferred tax asset was increased by \$5.6 million with an offsetting increase of \$1.1 million to the valuation allowance related to a step-up in tax basis due to the share exchange which will result in additional tax deductions. The establishment of these net deferred tax assets also increased additional paid-in capital.

***Tax Receivable Agreement***

Although the tax receivable agreement payments are calculated based on annual tax savings, for the nine months ended September 30, 2011, the payments which would have been made pursuant to the tax receivable agreement, if such period was calculated by itself, were estimated to be \$12.3 million. During the nine months ended September 30, 2011, \$13.5 million was paid under the tax receivable agreement relating to 2009.

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

Due from affiliates was comprised of the following:

September 30, 2011	Private Equity		Liquid Hedge Funds	Hedge Funds	Credit		Total
	Funds	Castles			PE Funds	Other	
Management fees and incentive income (A)	\$ 95,233	\$ 3,887	\$ 217	\$ 19,302	\$ 17,205	\$	\$ 135,844
Expense reimbursements (A)	5,101	2,441	6,830	4,620	4,696		23,688
Expense reimbursements - FCF (A) (B)	49,220						49,220
Dividends and distributions		154					154
Other	31	655			1,960	4,271	6,917

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

Total \$ 149,585 \$ 7,137 \$ 7,047 \$ 23,922 \$ 23,861 \$ 4,271 \$ 215,823

December 31, 2010	Private Equity		Liquid Hedge Funds	Hedge Funds	Credit		Total
	Funds	Castles			PE Funds	Other	
Management fees and incentive income (A)	\$ 53,282	\$ 3,836	\$ 47,920	\$ 108,623	\$ 15,508	\$	\$ 229,169
Expense reimbursements (A)	1,170	3,081	2,296	3,790	3,949	4	14,290
Expense reimbursements - FCF (B)	42,385						42,385
Dividends and distributions	762						762
Other	3	521	13,219		1	2,693	16,437
Total	\$ 97,602	\$ 7,438	\$ 63,435	\$ 112,413	\$ 19,458	\$ 2,697	\$ 303,043

(A) Net of allowances for uncollectable management fees and expense reimbursements of \$12.0 million and \$5.0 million at September 30, 2011, respectively, and of \$11.6 million and \$1.5 million as of December 31, 2010, respectively. Allowances are recorded as General and Administrative expenses.

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

As of September 30, 2011, amounts due from Fortress Funds recorded in Due from Affiliates included \$95.2 million of past due management fees, excluding \$12.0 million which has been fully reserved by Fortress, and \$34.0 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 portion of these fees will ultimately be collectable since the NAV's of the respective funds exceed the amounts owed.

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

Due to affiliates was comprised of the following:

	<b>September 30, 2011</b>		<b>December 31, 2010</b>
Principals - Tax receivable agreement - Note 5	\$ 282,198	\$	295,541
Distributions payable on Fortress Operating Group units	2,805		42,900
Other	7,855		3,956
General partner liability - Note 9	37,069		
	\$ 329,927	\$	342,397

***Other Related Party Transactions***

For the nine months ended September 30, 2011 and 2010, Other Revenues included approximately \$2.0 million and \$5.1 million, respectively, of revenues from affiliates, primarily dividends.

Fortress has entered into cost sharing arrangements with certain Fortress Funds, including market data services and subleases of certain of its office space. Expenses borne by these 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 nine months ended September 30, 2011 and 2010, these expenses approximated \$0.9 million and \$12.6 million, respectively.

In February 2011, Fortress made \$1.3 million of advances to senior employees (not officers) in connection with their investments in one of the Fortress Funds. These advances bear interest generally at LIBOR+4.25% and are due upon the maturity of the fund or, at Fortress's option, upon the termination of employment.

In February 2011, Fortress made a \$9.5 million advance to a senior employee (not an officer) in connection with his investments in Fortress Funds. This advance bore interest generally at LIBOR+4% and was repaid in March 2011.

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

In July 2011, Fortress committed to an aggregate of \$2.6 million of advances to senior employees (not officers) in connection with their investments in one of the Fortress Funds. These advances bear interest generally at LIBOR+4.25% and are due upon the maturity of the fund or upon certain events as defined in the related agreements.

In September 2011, Fortress contracted to sell a residential property that it had purchased in December 2010 from a senior employee. Fortress recorded a related loss of approximately \$0.4 million. The closing is expected to occur in the fourth quarter of 2011.

### *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:

	September 30, 2011	December 31, 2010
Fortress Operating Group units held by the Principals and one senior employee	\$ 460,572	\$ 458,842
Employee interests in majority owned and controlled fund advisor and general partner entities	60,874	57,609
Other	1,897	1,500
Total	\$ 523,343	\$ 517,951

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

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 September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Fortress Operating Group units held by the Principals and one senior employee	\$ (239,762)	\$ (179,768)	\$ (547,091)	\$ (520,543)
Employee interests in majority owned and controlled fund advisor and general partner entities	45	2,554	3,876	6,800
Other	(130)	(7)	40	484
Total	\$ (239,847)	\$ (177,221)	\$ (543,175)	\$ (513,259)

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 September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income (loss) attributable to Fortress	\$ (142,058)	\$ (94,655)	\$ (340,026)	\$ (271,190)
Transfers (to) from the Principals and Others Interests:				
Increase in Fortress's shareholders' equity for the conversion of Fortress Operating Group units by the Principals and one senior employee			3,845	7,188
Increase in Fortress's shareholders' equity for the delivery of Class A shares primarily in connection with vested RSUs and RPUs	5,275	2,795	13,137	10,328
Decrease in Fortress's shareholders' equity for the purchase of Fortress Operating Group units in connection with an equity offering				
Change from net income (loss) attributable to Fortress and transfers (to) from Principals and Others Interests	\$ (136,783)	\$ (91,860)	\$ (323,044)	\$ (253,674)

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

**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 September 30,		Nine Months September 30,	
	2011	2010	2011	2010
Equity-based compensation, per below	\$ 57,051	\$ 57,070	\$ 179,120	\$ 169,100
Profit-sharing expense, per below	13,125	32,286	89,027	111,720
Discretionary bonuses	46,458	54,932	141,708	133,611
Other payroll, taxes and benefits	41,792	39,819	125,404	108,598
	\$ 158,426	\$ 184,107	\$ 535,259	\$ 523,029

*Equity-Based Compensation*

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

	Employees		RSUs		Non-Employees		Restricted Shares Issued to Directors		RPU Employees	
	Number	Value (A)	Number	Value (A)	Number	Value (A)	Number	Value (A)	Number	Value (A)
Outstanding as of December 31, 2010	44,289,586	\$ 11.63	1,196,943	\$ 11.11	426,669	\$ 6.58	31,000,000	\$ 13.75		
Issued	6,324,792	5.54			143,624	5.23				
Converted to Class A shares	(14,902,391)	11.58	(389,677)	11.13					(4,749,434)	13.75
Converted to Class B shares									(5,583,899)	13.75
Forfeited	(739,478)	12.04								
Outstanding as of September 30, 2011 (B)	34,972,509	\$ 10.54	807,266	\$ 11.11	570,293	\$ 6.24	20,666,667	\$ 13.75		

Three Months Ended September 30,	Nine Months Ended September 30,
2011	2010

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

Expense incurred (B)								
Employee RSUs	\$	29,052	\$	32,137	\$	100,006	\$	93,766
Non-Employee RSUs		(310)		119		113		1,934
Restricted Shares (C)		38		164		327		325
LTIP				1,733				5,143
STIP (D)		5,353				10,590		
RPU		22,812		22,813		67,694		67,694
Logan Circle Comp Plan		106		104		390		238
Total equity-based compensation expense	\$	57,051	\$	57,070	\$	179,120	\$	169,100

(A) Represents the weighted average grant date estimated fair value per share or unit. The weighted average estimated fair value per unit as of September 30, 2011 for awards granted to non-employees was \$2.85.

(B) In future periods, Fortress will recognize compensation expense on its non-vested equity based awards outstanding as of September 30, 2011 of \$297 million, with a weighted average recognition period of 1.76 years. This does not include contingent amounts or amounts related to the Principals Agreement.

(C) Certain restricted shares granted to directors are recorded in General and Administrative Expense (\$0.8 million and \$0.2 million for the nine months ended September 30, 2011 and 2010, respectively) and therefore are not included above.

(D) STIP stands for Short Term Incentive Plan. In April 2011, one of the Principals entered into an agreement with a senior employee whereby such employee will receive 2,857,143 Fortress Operating Group units from such Principal if the employee remains with Fortress until January 2012. As a result of the service requirement, the fair value of these units is being charged to compensation expense in 2011.

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

When Fortress records equity-based compensation expense, including that related to the Principals Agreement, it records a corresponding increase in capital.

In April 2010, in connection with the acquisition of Logan Circle, Fortress created the Logan Circle Comp Plan. 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.

In January 2011, Fortress granted 5.2 million RSUs to its employees and affiliates valued at an aggregate of \$29.2 million on the grant date. These RSUs generally vest over two and a half years.

In August 2011, Fortress's Principals extended their employment for a new five-year term effective January 1, 2012, on substantially similar terms and conditions as their current employment agreements. Under a new compensation plan adopted by Fortress, the Principals will receive payments ( Principal Performance Payments ) based on the performance of the existing AUM of Fortress's flagship hedge funds and on their success in raising and investing new funds in all businesses in 2012 and beyond. The Principal Performance Payments will be comprised of a mix of cash and equity, with the equity component becoming larger as performance, and the size of the payments, increases.

Specifically, the new compensation plan calls for payments of 20% of the incentive income earned from existing flagship hedge fund AUM and between 10% and 20% of the fund management distributable earnings of new AUM in all businesses. Payments of up to 10% of fund management distributable earnings before Principal Performance Payments, in each of the Principals' respective businesses, will be made in cash, and payments in excess of this threshold will be made in restricted share units that will vest over three years.

The Principals' new employment agreements contain customary post-employment non-competition and non-solicitation covenants. In order to ensure the Principals' compliance with such covenants, 50% of the after-tax cash portion of any Principal Performance Payments will be subject to mandatory investment in Fortress-managed funds, and such invested amounts will serve as collateral against any breach of those covenants.

The Principals are currently party to the Principals Agreement under which they are obligated to forfeit a percentage of their Fortress equity in the event that they voluntarily resign from Fortress prior to the fifth anniversary of Fortress's IPO (i.e., February 8, 2012). In order to align the termination of the Principals Agreement with the effective date of their new employment agreements, the Principals have amended the

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

expiration date of the Principals Agreement to December 31, 2011. As a result, all of the remaining expense related to this agreement, including \$99.1 million that would otherwise have been recognized in 2012, is being recorded as Principals Agreement Compensation in the Statement of Operations from the date of the amendment through December 31, 2011.

### *Profit Sharing Expense*

Recognized profit sharing compensation expense is summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Private equity funds	\$ 541	\$ 2,010	\$ 1,032	\$ 2,010
Castles				
Liquid hedge funds	5,057	6,395	16,338	12,577
Credit hedge funds (A)	(620)	18,832	24,001	24,690
Credit PE funds	8,147	5,049	47,656	72,443
Total	\$ 13,125	\$ 32,286	\$ 89,027	\$ 111,720

---

(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.

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

**8. EARNINGS PER SHARE AND DISTRIBUTIONS**

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

	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2011	
	Basic	Diluted	Basic	Diluted
<b>Weighted average shares outstanding</b>				
Class A shares outstanding	186,675,357	186,675,357	179,704,474	179,704,474
Fully vested restricted Class A share units with dividend equivalent rights	2,791,277	2,791,277	5,208,431	5,208,431
Fully vested restricted Class A shares	540,353	540,353	460,700	460,700
Fortress Operating Group units and fully vested RPUs exchangeable into Class A shares (1)		305,857,751		307,023,364
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	190,006,987	495,864,738	185,373,605	492,396,969
<b>Basic and diluted net income (loss) per Class A share</b>				
Net income (loss) attributable to Class A shareholders	\$ (142,058)	\$ (142,058)	\$ (340,026)	\$ (340,026)
Dilution in earnings due to RPUs 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)	(1,561)	(1,561)	(3,698)	(3,698)
Dividend equivalents declared on non-vested restricted Class A shares and restricted Class A share units				

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

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 and fully vested RPU's exchangeable into Class A shares (1)			(267,989)		(580,511)
Net income (loss) available to Class A shareholders	\$	(143,619)	\$	(411,608)	\$ (343,724) \$ (924,235)
Weighted average shares outstanding		190,006,987		495,864,738	185,373,605 492,396,969
Basic and diluted net income (loss) per Class A share	\$	(0.76)	\$	(0.83)	\$ (1.85) \$ (1.88)

	Three Months Ended September 30, 2010		Nine Months Ended September 30, 2010		
	Basic	Diluted	Basic	Diluted	
<b>Weighted average shares outstanding</b>					
Class A shares outstanding	166,657,562	166,657,562	158,130,022	158,130,022	
Fully vested restricted Class A share units with dividend equivalent rights	2,024,800	2,024,800	5,632,820	5,632,820	
Fully vested restricted Class A shares	224,744	224,744	157,170	157,170	
Fortress Operating Group units exchangeable into Class A shares (1)		300,273,852		302,746,380	
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	168,907,106	469,180,958	163,920,012	466,666,392	
<b>Basic and diluted net income (loss) per Class A share</b>					
Net income (loss) attributable to Class A shareholders	\$	(94,655)	\$	(94,655)	\$ (271,190) \$ (271,190)
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)		(1,487)		(1,487)	(8,195) (8,195)
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)			(193,716)	(537,696)	
Net income (loss) available to Class A shareholders	\$	(96,142)	\$	(289,858)	\$ (279,385) \$ (817,081)
Weighted average shares outstanding		168,907,106		469,180,958	163,920,012 466,666,392
Basic and diluted net income (loss) per Class A share	\$	(0.57)	\$	(0.62)	\$ (1.70) \$ (1.75)



Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

(1) The Fortress Operating Group units and fully vested RPUs not held by Fortress (that is, those held by the Principals and one senior employee) are exchangeable into Class A shares on a one-to-one basis. These units and fully vested RPUs are not included in the computation of basic earnings per share. These units and fully vested RPUs 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 losses 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 September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Share Units	21,556,226	24,528,522	24,233,838	26,554,051

(4) Fortress Operating Group RPUs are eligible to receive partnership distribution equivalent payments when distributions are declared and paid on Fortress Operating Group units. The RPUs 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:

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

	Weighted Average		Weighted Average	
	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Class A shares (public shareholders)	186,675,357	166,657,562	179,704,474	158,130,022
Restricted Class A shares (directors)	570,293	426,669	506,213	310,168
Restricted Class A share units (employees) (A)	2,791,277	2,024,800	5,208,431	5,632,820
Restricted Class A share units (employees) (B)	13,820,478	18,992,319	14,104,896	19,474,536
Fortress Operating Group units (Principals and one senior employee)	305,857,751	300,273,852	304,487,344	302,746,380
Fortress Operating Group RPU (one senior employee)	20,666,667	31,000,000	23,202,687	31,000,000
Total	530,381,823	519,375,202	527,214,045	517,293,926

	As of September 30, 2011	As of December 31, 2010
Class A shares (public shareholders)	189,136,278	169,110,299
Restricted Class A shares (directors)	570,293	426,669
Restricted Class A share units (employees) (A)	696,977	1,058,331
Restricted Class A share units (employees) (B)	13,667,930	19,257,978
Fortress Operating Group units (Principals and one senior employee)	305,857,751	300,273,852
Fortress Operating Group RPU (one senior employee)	20,666,667	31,000,000
Total	530,595,896	521,127,129

(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 2011, 10.0 million existing RSUs and 10.3 million existing RPUs vested and the related Class A and Class B shares, as applicable, were delivered, or, in the case of certain RSUs, are expected to be delivered within six months of vesting pursuant to the plan documents. In March 2011, one senior employee exchanged an aggregate of 4,749,434 FOG units and Class B shares for an equal number of Class A shares. A portion of the vested shares are being sold to cover withholding tax requirements.

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

Dividends and distributions during the nine months ended September 30, 2011 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 and one senior employee) (B)	38,886	17,274	2,627	19,901
Distributions to Fortress Operating Group RPU holders (Note 7) (B)	4,014	1,279	178	1,457
Total distributions	\$ 42,900	\$ 18,553	\$ 2,805	\$ 21,358

(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 FOGU holders (the Principals and one senior employee) and the RPU holder (one senior employee).

Fortress's board of directors has approved a dividend of \$0.05 per Class A share related to the fourth quarter of 2011. The dividend has not yet been declared.

The following table summarizes our comprehensive income (loss) (net of taxes) for the nine months ended September 30, 2010:

	Impact to Total Fortress Shareholders Equity	Impact to Principals and Others' Interests in Equity of Consolidated Subsidiaries	Impact to Total Equity
<u>Nine Months Ended September 30, 2010</u>			
Net income (loss)	\$ (271,190)	\$ (513,259)	\$ (784,449)

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

Foreign currency translation	239	23	262
Comprehensive income (loss) from equity method investees	(1,056)	(3,524)	(4,580)
Total comprehensive income (loss)	\$ (272,007)	\$ (516,760)	\$ (788,767)

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

**9. COMMITMENTS AND CONTINGENCIES**

Other than as described below, Fortress's commitments and contingencies remain materially unchanged from December 31, 2010.

**General Partner Liability** Certain of Fortress's 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 on the balance sheet of the general partner entity. Such amount would be recorded on the Fortress balance sheet in consolidation until it is legally resolved. While these entities are limited liability companies and generally have no material assets other than their general partner interests, these entities and Fortress may be subject to litigation in connection with such amounts if fund creditors choose to sue Fortress to seek repayment. See *Litigation* below.

In March 2011, one private equity fund fell into a negative equity position, after considering all of Fortress's interests in such fund and its reserves related thereto. As described above, the amount of the negative equity was recorded, through earnings (losses) from equity method investees, by the general partner entity and is therefore included in the consolidated financial statements of Fortress. When the fund matures and is liquidated, Fortress will record a gain in the event and to the extent it does not fund this negative equity. The amount of negative equity recorded at September 30, 2011 was \$37.1 million.

**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 September 30, 2011, if any, will not materially affect Fortress's results of operations, liquidity or financial position.

**Private Equity Fund and Credit PE Fund Capital Commitments** Fortress has remaining capital commitments to certain of the Fortress Funds which aggregated \$91.7 million as of September 30, 2011. 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.

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

Minimum future rent payments under these leases are as follows:

October 1 to December 31, 2011	\$	5,311
2012		21,620
2013		21,357
2014		20,475
2015		18,877
2016		17,027
Thereafter		1,942
Total	\$	106,609

Rent expense, including operating escalations, during the nine months ended September 30, 2011 and 2010 was \$20.8 million and \$16.7 million, respectively, and was included in General, Administrative and Other Expense.

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

**10. SEGMENT REPORTING**

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 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 (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), and restricted shares),
- (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 or intangible assets 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)**

SEPTEMBER 30, 2011

(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) any 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 net asset value for nonpublic investments,
- (ii) employees and others 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, 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, and
- (iv) at interim periods, the accrued incentive income recorded for distributable earnings purposes in relation to the incentive income reconciling item in (i)(b) above.

In 2011, Fortress's management changed the method by which segment investments in funds are reported from cost basis to Fortress's share of the fund's net asset value. Fortress also changed the method by which segment investments in options are reported from intrinsic value to estimated fair value.

In the second quarter of 2011, Fortress reorganized its segments by moving two of its funds, Fortress Partners Fund LP and Fortress Partners Offshore Fund LP, from its Credit Hedge Fund segment to its Liquid Hedge Fund segment. The funds were moved to reflect a change in the way the business is reviewed and assessed by its chief operating decision maker. All of Fortress's internal reports have been changed to reflect this reorganization and Fortress's allocable expenses are now allocated amongst the segments based on this reorganization. Furthermore, responsibility for these funds has been transferred to management of the Liquid Hedge Fund segment.

As required, the segment reorganization described above has been reflected on a retrospective basis for all periods presented.



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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

*Distributable Earnings Impairment*Clawback Reserve on Incentive Income for DE Purposes

Fortress had recognized incentive income for DE purposes from certain private equity funds and credit PE funds, which are subject to contingent clawback, as of September 30, 2011:

<b>Fund</b>	<b>Net Intrinsic Clawback (A)</b>	<b>Periods in Intrinsic Clawback</b>	<b>Prior Year-End Inception-to-Date Net DE Reserve</b>	<b>Current Year-to-Date Gross DE Reserve</b>	<b>Current Year-to-Date Net DE Reserve</b>	<b>Inception-to-Date Net DE Reserve</b>	<b>Notes</b>
Fund I	N/A	N/A	N/A	N/A	N/A	N/A	(B)
Fund II	\$ 10,886	12 Quarters	\$ 8,520	\$ 4,538	\$ 2,915	\$ 11,435	(C)
Fund III	45,108	15 Quarters	45,108			45,108	(D)
FRID	10,041	17 Quarters	10,041			10,041	(D)
Credit Opportunities Fund	N/A	N/A	N/A	N/A	N/A	N/A	(E)
Credit Opportunities Fund II	N/A	N/A	N/A	N/A	N/A	N/A	(E)
FTS SIP L.P.	N/A	N/A	N/A	N/A	N/A	N/A	(E)
Assets Overflow Fund	N/A	N/A	N/A	N/A	N/A	N/A	(F)
<b>Total</b>	<b>\$ 66,035</b>		<b>\$ 63,669</b>	<b>\$ 4,538</b>	<b>\$ 2,915</b>	<b>\$ 66,584</b>	

(A) See Note 2.

(B) The incentive income from this fund is no longer subject to contingent clawback.

(C) The net intrinsic clawback in this fund, after the employee portion, in excess of previously recorded reserves was approximately \$2.4 million immediately prior to September 30, 2011. Based on the criteria determined by the CODM, management determined that an additional reserve of \$2.9 million was required.

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

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

(E) These funds had significant undistributed gains at September 30, 2011. As a result, the CODM determined that no reserve for clawback was required.

(F) This fund had resolved all of its investments and had a NAV close to zero and no intrinsic clawback at September 30, 2011. As a result, the CODM determined that no reserve for clawback was required.

### Impairment Determination

During the nine months ended September 30, 2011, Fortress recorded \$2.9 million of impairment on its direct and indirect investments in its funds for segment reporting purposes. As of September 30, 2011, Fortress had \$1.0 million of unrealized losses on certain investments that have not been recorded as impairment. As of September 30, 2011, Fortress's share of the net asset value of its direct and indirect investments exceeded its segment cost basis by \$280.3 million, representing unrealized gains.

During the nine months ended September 30, 2011, Fortress recorded a \$2.9 million net clawback reserve for DE purposes, as shown above.

Fortress expects aggregate returns on its private equity funds and credit PE funds that are in an unrealized investment loss or intrinsic clawback position, after taking reserves into account, to ultimately exceed their carrying amount or breakeven point, as applicable. If such funds were liquidated at their September 30, 2011 NAV (although Fortress has no current intention of doing so), the result would be additional impairment losses and reserves for DE purposes of approximately \$1.0 million.

### Segment Results of Operations

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.

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

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

**September 30, 2011 and the Nine Months Then Ended**

	Private Equity		Liquid	Credit		PE	Principal	Unallocated	Fortress
	Funds	Castles	Hedge	Hedge	Funds	Funds	Investments		Subtotal
			Funds	Funds					
<b>Segment revenues</b>									
Management fees	\$ 101,443	\$ 39,542	\$ 83,859	\$ 96,122	\$ 52,187	\$	\$ 14,767	\$	\$ 387,920
Incentive income	(1,748)		4,526	49,923	99,666				152,367
<b>Segment revenues - total</b>	<b>\$ 99,695</b>	<b>\$ 39,542</b>	<b>\$ 88,385</b>	<b>\$ 146,045</b>	<b>\$ 151,853</b>	<b>\$</b>	<b>\$ 14,767</b>	<b>\$</b>	<b>\$ 540,287</b>
<b>Fund management</b>									
distributable earnings (loss)	\$ 69,878	\$ 19,375	\$ 14,291	\$ 27,628	\$ 80,776	\$	\$ (12,197)	\$	\$ 199,751
Pre-tax distributable earnings (loss)	\$ 69,878	\$ 19,375	\$ 14,291	\$ 27,628	\$ 80,776	\$ (7,473)	\$ (12,197)	\$	\$ 192,278
<b>Total segment assets</b>	<b>\$ 150,456</b>	<b>\$ 6,328</b>	<b>\$ 9,803</b>	<b>\$ 68,470</b>	<b>\$ 23,325</b>	<b>\$ 1,367,963</b>	<b>\$ 538,981</b>	<b>\$</b>	<b>\$ 2,165,326</b>

(A)

(A) Unallocated assets include deferred tax assets of \$421.5 million.

**Three Months Ended September 30, 2011**

	Private Equity		Liquid	Credit		PE	Principal	Unallocated	Fortress
	Funds	Castles	Hedge	Hedge	Funds	Funds	Investments		Subtotal
			Funds	Funds					
<b>Segment revenues</b>									
Management fees	\$ 30,333	\$ 13,819	\$ 27,937	\$ 34,919	\$ 19,551	\$	\$ 4,940	\$	\$ 131,499
Incentive income	(3,077)		1,354	(4,274)	19,813				13,816
<b>Segment revenues - total</b>	<b>\$ 27,256</b>	<b>\$ 13,819</b>	<b>\$ 29,291</b>	<b>\$ 30,645</b>	<b>\$ 39,364</b>	<b>\$</b>	<b>\$ 4,940</b>	<b>\$</b>	<b>\$ 145,315</b>
<b>Fund management</b>									
distributable earnings (loss)	\$ 19,952	\$ 7,630	\$ 5,601	\$ (1,788)	\$ 23,595	\$	\$ (4,156)	\$	\$ 50,834
Pre-tax distributable earnings (loss)	\$ 19,952	\$ 7,630	\$ 5,601	\$ (1,788)	\$ 23,595	\$ (7,944)	\$ (4,156)	\$	\$ 42,890

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

Nine Months Ended September 30, 2010

	Private Equity		Liquid	Credit		PE	Principal	Unallocated	Fortress
	Funds	Castles	Hedge	Hedge	Funds	Funds	Investments		Subtotal
			Funds	Funds					
Segment revenues									
Management fees	\$ 102,705	\$ 35,856	\$ 72,485	\$ 94,691	\$ 32,171	\$	\$	8,603	\$ 346,511
Incentive income	5,436		26,119	52,397	140,845				224,797
Segment revenues - total	\$ 108,141	\$ 35,856	\$ 98,604	\$ 147,088	\$ 173,016	\$	\$	8,603	\$ 571,308
Fund management distributable earnings (loss)	\$ 79,670	\$ 13,338	\$ 32,171	\$ 41,149	\$ 82,067	\$	\$	(12,148)	\$ 236,247
Pre-tax distributable earnings (loss)	\$ 79,670	\$ 13,338	\$ 32,171	\$ 41,149	\$ 82,067	\$ 10,860	\$	(12,148)	\$ 247,107

Three Months Ended September 30, 2010

	Private Equity		Liquid	Credit		PE	Principal	Unallocated	Fortress
	Funds	Castles	Hedge	Hedge	Funds	Funds	Investments		Subtotal
			Funds	Funds					
Segment revenues									
Management fees	\$ 36,160	\$ 11,878	\$ 24,494	\$ 27,778	\$ 10,857	\$	\$	4,908	\$ 116,075
Incentive income	5,436		21,292	39,457	9,299				75,484
Segment revenues - total	\$ 41,596	\$ 11,878	\$ 45,786	\$ 67,235	\$ 20,156	\$	\$	4,908	\$ 191,559
Fund management distributable earnings (loss)	\$ 30,239	\$ 4,181	\$ 19,331	\$ 15,551	\$ 7,277	\$	\$	(5,443)	\$ 71,136
Pre-tax distributable earnings (loss)	\$ 30,239	\$ 4,181	\$ 19,331	\$ 15,551	\$ 7,277	\$ 6,540	\$	(5,443)	\$ 77,676

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

Reconciling items between segment measures and GAAP measures:

	Three Months Ended		Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
Fund management distributable earnings	\$ 50,834	\$ 71,136	\$ 199,751	\$ 236,247
Investment income (loss)	(3,415)	10,036	6,288	21,730
Interest expense	(4,529)	(3,496)	(13,761)	(10,870)
Pre-tax distributable earnings	42,890	77,676	192,278	247,107
Adjust incentive income				
Incentive income received from private equity funds and credit PE fund, subject to contingent repayment	\$ (19,813)	\$ (9,299)	\$ (99,666)	\$ (140,845)
Incentive income received from third parties, subject to contingent repayment			(988)	
Incentive income accrued from private equity funds and credit PE funds, not subject to contingent repayment	14,747	6,816	40,146	53,493
Incentive income received from private equity funds and credit PE funds, not subject to contingent repayment	(1,461)	(5,436)	(2,790)	(5,436)
Incentive income from hedge funds, subject to annual performance achievement	3,193	(59,707)	(46,106)	(69,438)
Incentive income received from the sale of shares related to options				
Reserve for clawback, gross (see discussion above)	4,538		4,538	
	1,204	(67,626)	(104,866)	(162,226)
Adjust other income				
Distributions of earnings from equity method investees**	(1,564)	(1,945)	(9,843)	(10,922)
Earnings (losses) from equity method investees**	(61,759)	7,013	21,527	24,263
Gains (losses) on options in equity method investees	(5,724)	95	(7,287)	199
Gains (losses) on other investments	(8,717)	1,950	(18,392)	(9,702)
Impairment of investments (see discussion above)	2,157	332	2,865	4,973
Adjust income from the receipt of options	5,594		12,615	
	(70,013)	7,445	1,485	8,811

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

Adjust employee and director compensation				
Adjust employee and director equity-based compensation expense	(57,078)	(56,019)	(179,788)	(169,054)
Adjust employee portion of incentive income from private equity funds accrued prior to the realization of incentive income	(1,623)		(1,623)	
	(58,701)	(56,019)	(181,411)	(169,054)
Adjust mark-to-market of contingent consideration in business combination	291	28	3,122	28
Adjust amortization of intangible assets and impairment of goodwill and intangible assets	(20,535)	(441)	(21,388)	(800)
Adjust Principals equity-based compensation expense	(279,623)	(239,975)	(751,749)	(712,101)
Adjust non-controlling interests related to Fortress Operating Group units	239,762	179,768	547,091	520,543
Adjust tax receivable agreement liability			(116)	1,317
Adjust income taxes	2,667	4,489	(24,472)	(4,815)
Total adjustments	(184,948)	(172,331)	(532,304)	(518,297)
Net Income (Loss) Attributable to Class A Shareholders	(142,058)	(94,655)	(340,026)	(271,190)
Principals and Others Interests in Income (Loss) of Consolidated Subsidiaries	(239,847)	(177,221)	(543,175)	(513,259)
Net Income (Loss)	\$ (381,905)	\$ (271,876)	\$ (883,201)	\$ (784,449)

\*\* This adjustment relates to all of the 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)**

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

	<b>September 30, 2011</b>			
Total segment assets	\$		2,165,326	
Adjust equity investments from segment carrying amount			(28,893)	
Adjust investments gross of employees and others portion			41,608	
Adjust goodwill and intangible assets to cost			(22,629)	
Accrued incentive income subject to annual performance achievement			(46,105)	
Total assets (GAAP)	\$		2,109,307	

  

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Segment revenues	\$ 145,315	\$ 191,559	\$ 540,287	\$ 571,308
Adjust management fees	125	305	375	(1,816)
Adjust incentive income	1,204	(67,626)	(106,755)	(165,146)
Adjust income from the receipt of options	5,594		12,615	
Adjust other revenues (including expense reimbursements)*	43,421	37,987	135,770	109,397
Total revenues (GAAP)	\$ 195,659	\$ 162,225	\$ 582,292	\$ 513,743

\*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.

	<b>Private Equity</b>		<b>Liquid</b>	<b>Credit</b>			
	<b>Funds</b>	<b>Castles</b>	<b>Hedge</b>	<b>Hedge</b>	<b>PE Funds</b>	<b>Unallocated</b>	<b>Total</b>
			<b>Funds</b>	<b>Funds</b>			
<b><u>Three Months Ended</u></b>							
<b><u>September 30,</u></b>							
<b>2011</b>							
Depreciation	\$ 437	\$ 102	\$ 454	\$ 1,203	\$ 74	\$ 962	\$ 3,232
Amortization (including impairment - Note 2)						20,535	20,535
Total	\$ 437	\$ 102	\$ 454	\$ 1,203	\$ 74	\$ 21,497	\$ 23,767

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

2010														
Depreciation	\$	450	\$	92	\$	401	\$	752	\$	217	\$	1,008	\$	2,920
Amortization												441		441
Total	\$	450	\$	92	\$	401	\$	752	\$	217	\$	1,449	\$	3,361

Nine Months Ended September 30,

2011														
Depreciation	\$	1,241	\$	292	\$	1,268	\$	2,917	\$	312	\$	2,696	\$	8,726
Amortization (including impairment - Note 2)												21,388		21,388
Total	\$	1,241	\$	292	\$	1,268	\$	2,917	\$	312	\$	24,084	\$	30,114

2010														
Depreciation	\$	1,214	\$	307	\$	1,243	\$	2,306	\$	637	\$	2,830	\$	8,537
Amortization												800		800
Total	\$	1,214	\$	307	\$	1,243	\$	2,306	\$	637	\$	3,630	\$	9,337

Table of Contents

**FORTRESS INVESTMENT GROUP LLC**

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

**11. SUBSEQUENT EVENTS**

These financial statements include a discussion of material events, if any, which have occurred subsequent to September 30, 2011 (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.

**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 nine months ended September 30, 2011.

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.

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

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

The consolidating balance sheet information is as follows:

	As of September 30, 2011			
	Fortress Operating Group Combined	Fortress Investment Group LLC Consolidated (A)	Intercompany Eliminations	Fortress Investment Group LLC Consolidated
<b>Assets</b>				
Cash and cash equivalents	\$ 280,641	\$ 33,097	\$	\$ 313,738
Due from affiliates	215,823	1,640	(1,640)	215,823
Investments	1,061,460	285,668	(285,668)	1,061,460
Deferred tax asset	3,627	417,883		421,510
Other assets	96,776			96,776
	\$ 1,658,327	\$ 738,288	\$ (287,308)	\$ 2,109,307
<b>Liabilities and Equity</b>				
<b>Liabilities</b>				
Accrued compensation and benefits	\$ 183,305	\$	\$	\$ 183,305
Due to affiliates	49,369	282,198	(1,640)	329,927
Deferred incentive income	260,673			260,673
Debt obligations payable	270,000			270,000
Other liabilities	85,969	11,651		97,620
	849,316	293,849	(1,640)	1,141,525
<b>Commitments and Contingencies</b>				
<b>Equity</b>				
Paid-in capital	5,124,185	1,837,651	(5,124,185)	1,837,651
Retained earnings (accumulated deficit)	(4,374,199)	(1,392,631)	4,374,199	(1,392,631)
Accumulated other comprehensive income (loss)	(3,745)	(581)	3,745	(581)
Total Fortress shareholders' equity (B)	746,241	444,439	(746,241)	444,439
Principals and others' interests in equity of consolidated subsidiaries	62,770		460,573	523,343
<b>Total Equity</b>	<b>809,011</b>	<b>444,439</b>	<b>(285,668)</b>	<b>967,782</b>
	\$ 1,658,327	\$ 738,288	\$ (287,308)	\$ 2,109,307

(A) Other than Fortress Operating Group.

(B) Includes the Principals (and one senior employee's) 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)**

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

The consolidating statement of operations information is as follows:

	<b>Nine Months Ended September 30, 2011</b>			
	<b>Fortress Operating Group Consolidated</b>	<b>Fortress Investment Group LLC Consolidated (A)</b>	<b>Intercompany Eliminations</b>	<b>Fortress Investment Group LLC Consolidated</b>
<b>Revenues</b>				
Management fees: affiliates	\$ 353,269	\$	\$	\$ 353,269
Management fees: non-affiliates	47,641			47,641
Incentive income: affiliates	44,361			44,361
Incentive income: non-affiliates	1,251			1,251
Expense reimbursements from affiliates	130,337			130,337
Other revenues	5,406	32	(5)	5,433
	582,265	32	(5)	582,292
<b>Expenses</b>				
Interest expense	13,749	139	(5)	13,883
Compensation and benefits	535,259			535,259
Principals agreement compensation	751,749			751,749
General, administrative and other	109,545			109,545
Depreciation and amortization (including impairment)	30,114			30,114
	1,440,416	139	(5)	1,440,550
<b>Other Income (Loss)</b>				
Gains (losses)	(26,751)			(26,751)
Tax receivable agreement liability adjustment		(116)		(116)
Earnings (losses) from equity method investees	26,417	(325,351)	325,351	26,417
	(334)	(325,467)	325,351	(450)
<b>Income (Loss) Before Income Taxes</b>	<b>(858,485)</b>	<b>(325,574)</b>	<b>325,351</b>	<b>(858,708)</b>
Income tax benefit (expense)	(10,041)	(14,452)		(24,493)
<b>Net Income (Loss)</b>	<b>\$ (868,526)</b>	<b>\$ (340,026)</b>	<b>\$ 325,351</b>	<b>\$ (883,201)</b>
<b>Principals and Others Interests in Income (Loss) of Consolidated Subsidiaries</b>				
	\$ 3,917	\$	\$ (547,092)	\$ (543,175)
<b>Net Income (Loss) Attributable to Class A Shareholders (B)</b>	<b>\$ (872,443)</b>	<b>\$ (340,026)</b>	<b>\$ 872,443</b>	<b>\$ (340,026)</b>

(A) Other than Fortress Operating Group.

(B) Includes net income (loss) attributable to the Principals (and one senior employee s) 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)**

SEPTEMBER 30, 2011

(dollars in tables in thousands, except share data)

The consolidating statement of cash flows information is as follows:

	<b>Nine Months Ended September 30, 2011</b>			
	<b>Fortress Operating Group Consolidated</b>	<b>Fortress Investment Group LLC Consolidated (A)</b>	<b>Intercompany Eliminations</b>	<b>Fortress Investment Group LLC Consolidated</b>
<b>Cash Flows From Operating Activities</b>				
Net income (loss)	\$ (868,526)	\$ (340,026)	\$ 325,351	\$ (883,201)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities				
Depreciation and amortization	30,114			30,114
Other amortization and accretion	1,119			1,119
(Earnings) losses from equity method investees	(26,417)	325,351	(325,351)	(26,417)
Distributions of earnings from equity method investees	19,775			19,775
(Gains) losses	26,751			26,751
Deferred incentive income	(40,146)			(40,146)
Deferred tax (benefit) expense	4,017	(1,093)		2,924
Options received from affiliates	(12,615)			(12,615)
Tax receivable agreement liability adjustment		116		116
Equity-based compensation, including Principals Agreement	930,869			930,869
Allowance for doubtful accounts	5,037			5,037
Cash flows due to changes in				
Due from affiliates	(55,539)	9,129	(9,129)	(55,539)
Other assets	9,707	11,073		20,780
Accrued compensation and benefits	(19,835)			(19,835)
Due to affiliates	(5,269)	(13,461)	9,129	(9,601)
Deferred incentive income	99,239			99,239
Other liabilities	23,404	8,448		31,852
Net cash provided by (used in) operating activities	121,685	(463)		121,222
<b>Cash Flows From Investing Activities</b>				
Contributions to equity method investees	(69,923)	(77,035)	77,035	(69,923)
Distributions of capital from equity method investees	179,258	32,145	(32,145)	179,258
Purchase of fixed assets	(13,350)			(13,350)
Net cash provided by (used in) investing activities	95,985	(44,890)	44,890	95,985
<b>Cash Flows From Financing Activities</b>				
Repayments of debt obligations	(7,500)			(7,500)
	(77,035)	77,035		

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

Issuance (purchase) of Class A shares (RSU settlements)

Capital contributions (distributions)	77,035		(77,035)	
Dividends and dividend equivalents paid	(32,145)		32,145	
Principals and others interests in equity of consolidated subsidiaries - contributions	13,074			13,074
Principals and others interests in equity of consolidated subsidiaries - distributions	(119,675)			(119,675)
Net cash provided by (used in) financing activities	(146,246)	77,035	(44,890)	(114,101)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	71,424	31,682		103,106
<b>Cash and Cash Equivalents, Beginning of Period</b>	209,217	1,415		210,632
<b>Cash and Cash Equivalents, End of Period</b>	\$ 280,641	\$ 33,097	\$	\$ 313,738

(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.*

**Overview**

*Our Business*

Fortress is a leading, highly diversified global investment management firm with approximately \$43.6 billion in AUM as of September 30, 2011. Fortress applies its deep experience and specialized expertise across a range of investment strategies—private equity, credit, liquid markets and traditional fixed income—on behalf of over 1,000 institutional clients and private investors worldwide. 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 September 30, 2011, we managed alternative assets in three core businesses:

**Private Equity**—a business that manages approximately \$12.7 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 \$6.2 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. In addition, this segment includes a fund-of-funds business, which invests in Fortress Funds, funds managed by external managers, and direct investments.

**Credit Funds**—a business that manages approximately \$11.8 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 non-Fortress originated funds for which Fortress has been retained as manager as part of an

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

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), two Asia funds, a Japan real estate fund and an Asian investor based global opportunities fund, and a real estate opportunities fund.

In addition, we treat our principal investments in these funds as a distinct business segment and we will not treat our traditional asset management business, which has \$12.9 billion of AUM, as a separate segment until such time as its operations become significant.

### *Understanding the Asset Management Business*

As an asset manager we perform a service we use our investment expertise to make investments on behalf of other parties (our fund investors ). An alternative asset manager is simply an asset manager that focuses on certain investment methodologies, typically hedge funds and private equity style funds as described below.

Private equity style funds are typically closed-end funds, which means they work as follows. We solicit fund investors to make capital commitments to a fund. Fund investors commit a certain amount of capital when the fund is formed. We may draw or call this capital from the fund investors as the fund makes investments. Capital is returned to fund investors as investments are realized. The fund has a set termination date and we must use an investment strategy that permits the fund to realize all of the investments it makes in the fund within that period. Fund investors may not withdraw or redeem capital, barring certain extraordinary circumstances, and additional fund investors are not permitted to join the fund once it is fully formed. Typically, private equity style funds make longer-term, less liquid (i.e. less readily convertible to cash) investments.

## Table of Contents

Hedge funds are typically open-end funds, which means they work as follows: we solicit fund investors to invest capital at the fund formation and invest this capital as it is received. Additional fund investors are permitted to join the fund on a periodic basis. Fund investors are permitted to redeem their capital on a periodic basis. The fund has an indefinite life, meaning that it continues for an indeterminate period as long as it retains fund investors. Typically, hedge funds make short-term, liquid investments. Our credit hedge funds share certain characteristics of both private equity and hedge funds, and generally make investments that are relatively illiquid in nature.

In addition, Fortress acquired a traditional asset management business during 2010. Although not yet significant to our operations, the traditional asset management business works similarly to the hedge fund business, except that generally there is no provision for incentive income and management fee rates are lower.

In exchange for our services, we receive remuneration in the form of management fees and incentive income. Management fees are typically based on a fixed annual percentage of the capital we manage for each fund investor, and are intended to compensate us for the time and effort we expend in researching, making, managing and realizing investments. Incentive income is typically based on achieving specified performance criteria, and it is intended to align our interests with those of the fund investors and to incentivize us to earn attractive returns.

We also invest our own capital alongside the fund investors in order to further align our interests and to earn a return on the investments.

In order to be successful, we must do a variety of things including, but not limited to, the following:

- Increasing the amount of capital we manage for fund investors, also known as our assets under management.
- Earning attractive returns on the investments we make.
- Effectively managing our liquidity, including our debt, and expenses.

Each of these objectives is discussed below.

## Assets Under Management

Assets under management, or AUM, fluctuate based on four primary factors:

- *Capital raising:* AUM increases when we receive more capital from our fund investors to manage on their behalf. Typically, fund investors make this decision based on: (a) the amount of capital they wish, or are able, to invest in the types of investments a certain

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

manager or fund makes, and (b) the reputation and track record of the manager and its key investment employees.

- *Realization of private equity investments:* In closed-end funds, AUM decreases when we return capital to fund investors as investments are realized. Investments are realized when they are sold or otherwise converted to cash by the manager.
- *Redemptions:* In open-end funds, AUM decreases after fund investors ask for their capital to be returned, or redeemed, at periodic intervals. Typically, fund investors make this decision based on the same factors they used in making the original investment, which may have changed over time or based on circumstances, as well as on their liquidity needs.
- *Fund performance:* AUM increases or decreases in accordance with the performance of fund investments.

It is critical for us to continue to raise capital from fund investors. Without new capital, AUM declines over time as private equity investments are realized and hedge fund investors redeem capital based on their individual needs. Therefore, we strive to maintain a good reputation and a track record of strong performance. We strive to also form and market funds in accordance with investor demand.

We disclose the changes in our assets under management below, under Results of Operations Assets Under Management.

### Performance

Performance can be evaluated in a number of ways, including the measures outlined below:

- *Fund returns.* Fund returns express the rate of return a fund earns on its investments in the aggregate. They can be compared to the returns of other managers, to returns offered by other investments or to broader indices. They can also be compared to the performance hurdles necessary to generate incentive income. We disclose our fund returns below, under Results of Operations Performance of Our Funds.
- *Proximity to incentive income threshold.* This is a measure of a fund's performance relative to the performance criteria it needs to achieve in order for us to earn incentive income.

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

### Table of Contents

Incentive income is calculated differently for the hedge funds and private equity funds, as described below.

- We generally earn incentive income from hedge funds based on a straight percentage of the returns of each fund investor, since fund investors may enter the fund at different times. Incentive payments are made periodically, typically annually for the Fortress hedge funds. Once an incentive payment is made, it is not refundable. However, if a particular fund investor suffers a loss on its investment, either from the date of the Fund's inception or since the last incentive payment to the manager, this establishes a high water mark for that investor, meaning a threshold that has to be exceeded in order for us to begin earning incentive income again from that fund investor. Investors in the same fund could have different high water marks, in terms of both percentage return and dollar amount.
- Since it is impractical to disclose this information on a fund investor-by-investor basis, it may be disclosed based on the following metrics: the percentage of fund investors who have a high water mark, and the aggregate dollar difference between the value of those fund investors' investments and their applicable aggregate high water mark. The investments held by fund investors who do not have a high water mark are eligible to generate incentive income for us on their next dollar earned.
- We generally earn incentive income from private equity style funds based on a percentage of the net returns of the fund, subject to the achievement of a minimum return (the preferred return) to fund investors. Incentive income is generally paid as each investment in the fund is realized, subject to a clawback. At the termination of such a fund, a computation is done to determine how much incentive income we should have earned based on the fund's overall performance, and any incentive income payments received by us in excess of the amount we should have earned must be returned by us (or clawed back) to the fund for distribution to fund investors. Certain of our private equity style funds pay incentive income only after all of the fund's invested capital has been returned.

Depending on where they are in their life cycle and how they have performed, private equity funds will fall into one of several categories as shown below:

Has the fund made incentive income payments to us?	PE Style Fund Status In a liquidation of the fund's assets at their estimated fair value as of the reporting date:		Key Disclosures  (Refer to Note 2 to our consolidated financial statements)
	Would the fund owe us incentive income?	Would we owe a clawback of incentive income to the fund?	
Yes	Yes	No	<ul style="list-style-type: none"> <li>• The amount of previously distributed incentive income.</li> <li>• The amount of undistributed incentive income, which is the amount of incentive income that would be due to us upon a liquidation of the fund's remaining assets at their current estimated fair value.</li> </ul>
Yes	No	Yes	<ul style="list-style-type: none"> <li>• The amount of previously distributed incentive income.</li> <li>• The intrinsic clawback, which is the amount of incentive income that we would have to return to the fund upon a liquidation of its remaining assets at their current estimated fair value.</li> <li>• The amount by which the total current fund value would have to increase as of the reporting date in order to reduce the intrinsic clawback to zero such that we would be in a position to earn additional incentive income from the fund in the future.</li> </ul>
No	Yes	N/A	<ul style="list-style-type: none"> <li>• The amount of undistributed incentive income, which is the amount of incentive income that would be due to us upon a</li> </ul>

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

liquidation of the fund's remaining assets at their current estimated fair value.

No

No

N/A

- The amount by which the total current fund value would have to increase as of the reporting date such that we would be in a position to earn incentive income from the fund in the future.

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

### Table of Contents

We disclose each of these performance measures, as applicable, for all of our funds in Note 2 to our consolidated financial statements contained herein.

### Liquidity, Debt and Expense Management

We may choose to use leverage, or debt, to manage our liquidity or enhance our returns. We strive to achieve a level of debt that is sufficient to cover working capital and investment needs, but not in an amount or way which causes undue stress on performance, either through required payments or restrictions placed on Fortress.

Our liquidity, and our ability to repay our debt, as well as the amount by which our metrics exceed those required under our debt covenants are discussed below, under Liquidity and Capital Resources, Debt Obligations, and Covenants.

We must structure our expenses, primarily compensation expense which is our most significant expense, so that key employees are fairly compensated and can be retained, while ensuring that expenses are not fixed in such a way as to endanger our ability to operate in times of lower performance or reduced liquidity. To this end, we generally utilize discretionary bonuses, profit sharing and equity-based compensation as significant components of our compensation plan.

- Profit sharing simply means that when profits increase, either of Fortress as a whole or of a specified component (such as a particular fund) of Fortress, employees receive increased compensation. In this way, employees' interests are aligned with Fortress's, employees can receive significant compensation when performance is good, and we are able to reduce expenses when necessary.
- Equity-based compensation simply means that employees are paid in equity of Fortress rather than in cash. This form of compensation has the advantage of never requiring a cash expenditure, while aligning employees' interests with those of Fortress.

Our liquidity is discussed below, under Liquidity and Capital Resources. Our compensation expenses, including profit sharing and equity-based, are discussed in Note 7 to our consolidated financial statements contained herein. Our segment operating margin, which we define as the ratio of our fund management distributable earnings to our segment revenues, and which is a measure of our profitability, is discussed in Note 10 to our consolidated financial statements contained herein.

### *Understanding our Financial Statements*

#### Balance Sheet

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

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 expense reimbursements.
- 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.
- 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.

Table of Contents

- 6) Debt covenants.
- 7) Likelihood of clawback of incentive income.

Income Statement

Our revenues and other income consist primarily of the following:

- 1) Fees and expense 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.
- 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 Results of Operations 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. Our traditional asset management business, Logan Circle Partners, L.P. ( Logan Circle or Logan Circle Partners ) 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 one senior employee) and income tax expense.

Management assesses the net performance of each segment based on its distributable earnings. Distributable earnings is not a measure of cash generated by operations 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.

Table of Contents

**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 our business 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 improved meaningfully over the last two years, it is not clear whether a sustained recovery will occur or, if so, for how long it will last. Many market participants remain concerned about the long-term health of the financial markets and the financial institutions and countries that participate in these markets. We and other market participants face 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 and our funds and may counteract the progress we have made over the last couple of years.

*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.

Beginning in mid-2007, the equity and debt markets experienced a significant deterioration. The deterioration of the debt markets in the United States was triggered by 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 impaired since that time, although securitization activity has increased in 2011. 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 in the debt markets 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.

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

Equity market conditions began to stabilize in the second quarter of 2009, and debt market conditions improved significantly in 2010. During 2009 and 2010, we were able to access the equity markets in the United States and abroad, including, for example, the IPOs of Rail America, Seacube Container Leasing Ltd. and Whistler Blackcomb Holdings Inc. as well as realizations of significant other positions in publicly traded securities of our portfolio companies. The improvement in the debt markets has enabled us and other market participants to refinance existing debt obligations and otherwise obtain debt financing with respect to our existing investments. However, while the debt market conditions have remained strong thus far in 2011, equity market conditions remain volatile and have been adversely affected by various factors, such as unrest in the Middle East, the earthquake in Japan, continuing weakness in the U.S. job market, the credit rating downgrading of U.S. government debt and the European debt crisis. We cannot predict future conditions of these markets or the impact of such conditions on our business.

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

- While conditions in the U.S. capital markets have improved meaningfully over the last two years, there currently is less debt and equity capital available in the market relative to the levels available from the early 2000s 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

Table of Contents

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. The maintenance of increased liquidity 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 in comparison to years prior to 2008, greater price volatility and weaker economic conditions around the globe. This has resulted in a significant reduction in the value of certain of our investments in comparison to years prior to 2008, which, in turn, has impacted our management fees, incentive income and investment income. Recently, such values have rebounded (significantly in many cases), but have not increased to their historical levels for all investments.

- The market prices of the investments held by our private equity funds in public companies decreased substantially from their high values, rebounded meaningfully in 2009 and the first quarter of 2010, but have experienced volatility since then. A decrease in these prices hinders our ability to realize gains within these funds and therefore our ability to earn incentive income, as well as impacting the value of our principal investments in such funds.

As a result of the above factors:

- We have not paid a dividend on our Class A shares since the second quarter of 2008. However, our board of directors has approved a revised dividend policy under which it will reinstate a \$0.05 per share quarterly dividend beginning in the fourth quarter of 2011. 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.

- Changes in the value of our funds' investments have impacted our future management fees, at an annual rate of up to 3% of the decline in aggregate fund NAV. See Fee Paying Assets Under Management below for a table summarizing our AUM.

- Changes in the value of our funds' investments have also impacted the relationship between the NAVs of our investors in our main credit and liquid hedge funds and their incentive income thresholds (high water marks). As a result of recent performance, the incentive income outlook for these funds has substantially improved from recent years. 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, or returns below threshold returns, 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, and, in some cases, the possibility that we will be liable for so-called clawback payments relating to incentive payments previously collected. The returns required are subject to a number of variables, such as: the amount of loss incurred, the amount of outstanding capital in the fund, the amount and timing of future capital draws and distributions, and the rate of preferential return earned by investors.

- Despite the volatile economic conditions, 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. This is 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 on investment products offered by alternative asset managers. We have benefited in 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 several 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 several years prior to 2009, institutions, high net worth individuals and other investors (including sovereign wealth funds) increased their allocations of

## Table of Contents

capital to the alternative investment sector. That said, university endowments, pension funds and other traditionally significant investors in the alternative investment sector have, in some cases, reduced the amount of capital they are investing in this sector since the onset of the recession. 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 through the first three quarters of 2011 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. In a similar vein, investors in long-term, locked-up (i.e. private equity style) funds have responded to the recession by engaging in longer, more intensive and detailed due diligence procedures prior to making commitments to invest in such funds, which has led to the general perception across the alternatives industry that capital raising for long-term capital will require longer time periods, a greater commitment of capital raising resources and will generally be more difficult overall than it was prior to the recession.

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 through the first three quarters of 2011, we have been able to raise meaningful additional capital in various funds, including newly formed funds. However, our ongoing ability to raise capital for new and existing funds will be a function of investors' perception about our investment performance relative to that of our competition in the post-recession environment, as well as other factors.

### *The strength of the sectors in which our funds have concentrated investments*

Our private equity funds, as well as certain of our managed accounts, currently have significant investments in companies whose assets are concentrated in the following industries and sectors: transportation, financial services (particularly loan servicing), leisure and gaming, real estate (including Florida commercial real estate and German residential real estate), and senior living facilities. If any of these industries or sectors were adversely affected by market conditions, sector-specific trends or other factors, in a systematic or uniform manner, it could have a disproportionately negative impact on those funds. For example, if the commercial real estate operating environment in Florida remains challenging or deteriorates further, our fund investments in Flagler Development Group could decline in value and potentially have a material adverse effect on the performance of the funds that are invested in Flagler.

### *Market Considerations Summary*

While 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 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 challenging conditions persist or intensify, or if generally improving conditions in our market reverse.

We do not currently know the full extent to which continued market 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, 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.

Table of Contents**Results of Operations**

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

	Nine Months Ended September 30,			Variance \$	Three Months Ended September 30,			Variance \$
	2011 (Unaudited)	2010 (Unaudited)			2011 (Unaudited)	2010 (Unaudited)		
<b>Revenues</b>								
Management fees: affiliates	\$ 353,269	\$ 327,182	\$ 26,087	\$ 118,353	\$ 107,752	\$ 10,601		
Management fees: non-affiliates	47,641	17,513	30,128	18,865	8,628	10,237		
Incentive income: affiliates	44,361	53,892	(9,531)	14,754	7,487	7,267		
Incentive income: non-affiliates	1,251	5,759	(4,508)	266	371	(105)		
Expense reimbursements from affiliates	130,337	100,606	29,731	42,350	36,745	5,605		
Other revenues	5,433	8,791	(3,358)	1,071	1,242	(171)		
	582,292	513,743	68,549	195,659	162,225	33,434		
<b>Expenses</b>								
Interest expense	13,883	11,043	2,840	4,583	3,549	1,034		
Compensation and benefits	535,259	523,029	12,230	158,426	184,107	(25,681)		
Principals agreement compensation	751,749	712,101	39,648	279,623	239,975	39,648		
General, administrative and other expense (including depreciation, amortization and impairment)	139,659	81,307	58,352	57,932	29,981	27,951		
	1,440,550	1,327,480	113,070	500,564	457,612	42,952		
<b>Other Income (Loss)</b>								
Gains (losses)	(26,751)	(10,360)	(16,391)	(15,229)	2,025	(17,254)		
Tax receivable agreement liability adjustment	(116)	1,317	(1,433)					
Earnings (losses) from equity method investees	26,417	42,972	(16,555)	(64,483)	16,941	(81,424)		
	(450)	33,929	(34,379)	(79,712)	18,966	(98,678)		
<b>Income (Loss) Before Income Taxes</b>								
	(858,708)	(779,808)	(78,900)	(384,617)	(276,421)	(108,196)		
Income tax benefit (expense)	(24,493)	(4,641)	(19,852)	2,712	4,545	(1,833)		
<b>Net Income (Loss)</b>	\$ (883,201)	\$ (784,449)	\$ (98,752)	\$ (381,905)	\$ (271,876)	\$ (110,029)		

*Factors Affecting Our Business*

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

- changes in our AUM;

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

- level of performance of our funds; and
- changes in the size of our fund management and investment platform and our related compensation structure.

Each of these factors is described below.

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

### Table of Contents

### Assets Under Management

We measure AUM by reference to the fee paying assets we manage. 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.

Our AUM has changed for the nine months ended September 30, 2011 as follows (in millions):

	Private Equity		Liquid Hedge		Credit		Logan Circle		
	Funds	Castles	Funds	Hedge Funds	PE Funds (J)	Partners, L.P.			Total
<b>2011</b>									
AUM December 31, 2010	\$ 11,923	\$ 3,037	\$ 6,355	\$ 6,773	\$ 4,817	\$ 11,708			\$ 44,613
Capital raised (A)		220	1,141	288	190				1,839
Increase in invested capital	224		11	107	2,090				2,432
Capital acquisitions									
Redemptions (B)			(986)	(145)					(1,131)
SPV distributions (C)									
RCA distributions (D)				(968)					(968)
Return of capital distributions (E)	(313)			(119)	(1,495)				(1,927)
Adjustment for reset date (F)	(1,997)								(1,997)
Crystallized incentive income (G)			(69)	(91)					(160)
Equity buyback (H)		(19)							(19)
Net client flows (traditional)						476			476
Income (loss) and foreign exchange (I)	(366)	(1)	(287)	369	17	729			461
AUM September 30, 2011	\$ 9,471	\$ 3,237	\$ 6,165	\$ 6,214	\$ 5,619	\$ 12,913			\$ 43,619

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

(B) Excludes redemptions which reduced AUM subsequent to September 30, 2011.

(C) Mainly 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 of certain private equity or credit PE funds is an event determined by the earliest occurrence of (i) the first day following the expiration of the capital commitment period of a fund, (ii) a successor fund or entity draws capital contributions or charges management fees

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

or (iii) the date on which all unpaid capital obligations have been cancelled. For the period commencing with the initial closing of or contribution to the fund and ending on the last day of the semi-annual or quarterly period ending on or after the reset date, certain funds generate management fees as a percentage of the fund's capital commitments and certain funds generate management fees as a percentage of the fund's aggregate capital contributions. Thereafter, such funds generally generate management fees as a percentage of the aggregate capital contributed adjusted for the fair value of each investment that is below the associated investment's contributed capital.

- (G) Represents the transfer of value from investors (fee paying) to Fortress (non-fee paying) related to realized hedge fund incentive income.
- (H) Represents buybacks of equity interests by the Castles.
- (I) Represents the change in fee-paying NAV resulting from realized and unrealized changes in the reported value of the fund.
- (J) As of September 30, 2011, the credit PE funds had approximately \$3.0 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 the NAV or fair value for 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.

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

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 September 30,		Returns (B) Inception to September 30, 2011	
			2011	2010		
<b>Private Equity</b>						
<i>Private Equity Funds that Report IRR s</i>						
Fund I	Nov-99	(A) \$	\$			25.7%
Fund II	Jul-02	Feb-13		200		35.5%
Fund III	Sep-04	Jan-15	1,286	1,315		0.4%
Fund III Coinvestment	Nov-04	Jan-15	88	119		(0.4)%
Fund IV	Mar-06	Jan-17	2,417	2,330		(4.5)%
Fund IV Coinvestment	Apr-06	Jan-17	560	548		(5.8)%
Fund V	May-07	Feb-18	2,627	3,964		(5.8)%
Fund V Coinvestment	Jul-07	Feb-18	547	935		(16.8)%
GAGACQ Coinvestment Fund	Sep-04	Permanent				15.8%
FRID	Mar-05	Apr-15	349	434		(12.5)%
FRIC	Mar-06	May-16	75	98		(17.5)%
FICO	Aug-06	Jan-17		36		(100.0)%
FHIF	Dec-06	Jan-17	1,055	994		7.5%
FECI	Jun-07	Feb-18	458	532		(3.7)%
WWTAI	Jul-11	Jun-24	9			(C)
<b>Private Equity Funds that Report Annual Returns</b>						
Mortgage Opportunities Fund III	Jun-08	Jun-11	115	(6.1)%	0.3%	9.7%
<i>Private Equity - Castles</i>						
Newcastle Investment Corp.	Jun-98	Permanent	1,294	1,102	N/A	N/A
Eurocastle Investment Limited (E)	Oct-03	Permanent	1,943	1,971	N/A	N/A
<b>Liquid Hedge Funds</b>						
Drawbridge Global Macro Funds	Jun-02	Redeemable	386	408	8.2%	(8.3)%
Fortress Macro Funds	May-09	Redeemable	2,400	2,216	5.0%	(7.3)%
Fortress Commodities Funds	Jan-08	Redeemable	810	803	4.4%	0.9%
Fortress Commodities Fund MA1 Ltd	Nov-09	Redeemable	104	97	1.9%	1.1%
Fortress Partners Fund LP	Jul-06	Redeemable	770	840	1.4%	0.2%
Fortress Partners Offshore Fund LP	Nov-06	Redeemable	670	764	1.7%	(1.6)%
Fortress Asia Macro Funds	Mar-11	Redeemable	189		(C)	(C)
<b>Credit Hedge Funds</b>						
Drawbridge Special Opp s Fund LP (F)	Aug-02	PE style redemption	4,117	4,361	10.2%	6.4%
Drawbridge Special Opp s Fund LTD (F)	Aug-02	PE style redemption	853	625	10.7%	9.1%
Worden Fund	Jan-10	PE style redemption	191	130	10.9%	4.7%

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

Worden Fund II	Aug-10	PE style redemption	20	10	10.3%	6.3%	(C)
Value Recovery Funds and related assets	(G)	Non-redeemable	987	1,786	(G)	(G)	(G)

Continued on next page.

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

Table of Contents

Name of Fund	Inception Date	Maturity Date (A)	AUM September 30,		Returns (B)
			2011	2010	Inception to September 30, 2011
<b>Credit PE Funds</b>					
Credit Opportunities Fund	Jan-08	Oct-20	1,275	1,127	28.1%
Credit Opportunities Fund II	Jul-09	Jul-22	1,064	695	16.4%
Credit Opportunities Fund III	Sep-11	Mar-24	63		(C)
FTS SIP LP	Sep-08	Oct-18	432	321	26.8%
FCO MA LSS	May-10	Jun-24	114	47	(C)
FCO MA II	Jun-10	Jun-22	262	114	(C)
FCO MA Maple Leaf	Oct-10	Oct-20	175		(C)
Long Dated Value Fund I	Apr-05	Apr-30	201	201	3.8%
Long Dated Value Fund II	Nov-05	Nov-30	161	204	3.9%
Long Dated Value Fund III	Feb-07	Feb-32	198	243	8.7%
LDVF Patent Fund	Nov-07	Nov-27	14	14	13.8%
Real Assets Fund	Jun-07	Jun-17	118	166	9.5%
Assets Overflow Fund	Jul-08	May-18		34	(C)
Japan Opportunity Fund	Jun-09	Jun-19	956	882	(C)
Net Lease Fund I	Jan-10	Feb-20	53	29	(C)
Global Opportunities Fund	Sep-10	Sep-20	349	50	(C)
Life Settlements Fund	Dec-10	Dec-22	161		(C)
Life Settlements Fund MA	Dec-10	Dec-22	14		(C)
Subtotal - all funds			29,815	30,860	
Managed accounts			891	843	
Total - Alternative Investments			30,706	31,703	
Logan Circle Partners, L.P.			12,913	12,289	
Total (H)			\$ 43,619	\$ 43,992	

(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. Investor capital in the liquid hedge funds and the Fortress Partners Funds is generally redeemable at the option of the fund investors; however, a substantial portion of the Drawbridge Global Macro Funds' investor capital is not redeemable by its investors and such capital will only be distributed as underlying assets are realized. The Drawbridge Special Opportunities Funds and Worden Funds may pay redemptions over time, as the underlying investments are realized, in accordance with their governing documents (PE style redemption). The 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 80% of our alternative investment AUM as of September 30, 2011.

(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 2011 and 2010 ROE is not meaningful because Newcastle had negative book equity.

For liquid and credit hedge funds, 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

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

things, whether fund investors are invested in one or more special investments.

For the Mortgage Opportunities Fund, returns represent the ratio of periodic performance to original contributed capital.

For Fortress Commodities Funds, returns include the combined returns of Fortress Commodities Fund LP and Fortress Commodities Fund Ltd, the latter of which commenced operations in July 2011.

(C) These funds had no successor fund formed and either (a) were in their investment periods and had capital, other than recallable capital, remaining to invest, or (b) had less than one year elapsed from their inception, through September 30, 2011.

(D) For liquid hedge funds and credit hedge funds, reflects a composite of monthly returns presented on an annualized net return basis. For the Mortgage Opportunities Fund, reflects the ratio of inception-to-date performance to original contributed capital on an annualized basis.

(E) Interim returns for Eurocastle Investment Limited are only reported on a semi-annual basis at June 30 of each calendar year.

(F) 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).

(G) 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.

(H) In addition to the funds listed, Fortress manages NIH, FPRF, Mortgage Opportunities Funds I and II and Real Estate Opportunities Fund. 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. Private Equity Fund I and GAGACQ Coinvestment Fund had zero AUM as of both September 30, 2011 and 2010, but for purposes of continuity of presentation, the returns of these funds have been left on the table.

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 continue 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.

In determining our segment measure of operations, distributable earnings, we generally recognize private equity style incentive income when gains are realized and hedge fund incentive income based on current returns, and we recognize our employees' share of this income as compensation expense at the same time. In contrast, GAAP requires that we likewise recognize the compensation when incurred, but we must defer the recognition of the revenue until all contingencies, primarily minimum returns over the lives of the private equity style funds and annual performance requirements of the hedge funds, are resolved regardless of the probability of such returns being met. As a result, when we have significant PE style realizations or positive returns in interim periods in our hedge funds, which we regard as positive events, the related incentive income impact improves our segment distributable earnings while reducing our GAAP results for the same period.

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 headcount increased from 897 employees as of September 30, 2010 to 970 employees as of September 30, 2011.

Revenues

*Nine months ended September 30*

Total revenues were \$582.3 million for the nine months ended September 30, 2011, a net increase of \$68.5 million, compared to \$513.7 million for the nine months ended September 30, 2010. The increase in revenues was primarily attributable to increases of \$26.1 million and \$30.1 million in management fees from affiliates and non-affiliates, respectively, and an increase of \$29.7 million in expense reimbursements from affiliates. These increases were partially offset by decreases of \$9.5 million and \$4.5 million in incentive income from affiliates and non-affiliates, respectively, and a decrease of \$3.4 million in other revenues.

The increases in management fees from affiliates and non-affiliates were primarily attributable to a \$12.1 billion increase in AUM from \$31.5 billion as of December 31, 2009 to \$43.6 billion as of September 30, 2011, including \$11.4 billion of AUM acquired through Logan Circle, plus an increase of \$12.6 million due to Newcastle options granted to the company. The increase in expense reimbursements from affiliates was primarily attributable to our consolidation of FCF, the operating subsidiary of one of our private equity funds, effective March 2010. The

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

decrease in incentive income from affiliates of \$9.5 million was primarily due to a decrease in incentive income recognized from certain of our private equity funds, which are recognized as contingencies for repayment are resolved, and was partially offset by an increase in incentive income from certain of our credit PE funds primarily due to an increase in incentive distributions which are not subject to clawback. The decrease in incentive income from non-affiliates of \$4.5 million was primarily attributable to a reduction in incentive income from a third party account in our credit hedge funds whose investments were fully realized in 2010, and was partially offset by crystallized incentive income from a managed account in our liquid hedge funds which launched in August 2010. The \$3.4 million decrease in other revenues was primarily related to a decrease in dividend income.

### *Three months ended September 30*

Total revenues were \$195.7 million for the three months ended September 30, 2011, a net increase of \$33.4 million, compared to \$162.2 million for the three months ended September 30, 2010. The increase in revenues was primarily attributable to increases of \$10.6 million and \$10.2 million in management fees from affiliates and non-affiliates, respectively, an increase of \$7.3 million in incentive income from affiliates, and an increase of \$5.6 million in expense reimbursements from affiliates.

The increases in management fees from affiliates and non-affiliates were primarily attributable to a \$1.9 billion increase in AUM from \$41.7 billion as of June 30, 2010 to \$43.6 billion as of September 30, 2011, plus an increase of \$5.6 million due

Table of Contents

to Newcastle options granted to the company. The increase in incentive income from affiliates of \$7.3 million was primarily due to an increase in incentive income from certain of our credit PE funds primarily due to an increase in incentive distributions which are not subject to clawback.

Expenses

*Nine months ended September 30*

Expenses were \$1,440.6 million for the nine months ended September 30, 2011, an increase of \$113.1 million, compared to \$1,327.5 million for the nine months ended September 30, 2010. The increase was primarily attributable to an increase of \$12.2 million in compensation and benefits, an increase of \$39.6 million in principals agreement compensation and an increase of \$58.4 million in general, administrative and other expenses.

Total compensation and benefits increased primarily due to increases in base compensation, discretionary bonuses and equity-based compensation, partially offset by a net decrease in profit sharing expenses primarily related to our credit PE funds. The increase in base compensation and discretionary bonuses was primarily due to our consolidation of FCF and Logan Circle effective March 2010 and April 2010, respectively, and an increase in our employee headcount for the nine months ended September 30, 2011 as compared to the prior comparative period. The increase in principals agreement compensation resulted from the acceleration of the agreement's maturity date from February 2012 to December 2011. The increase in general, administrative and other expenses was primarily due to (i) an impairment of goodwill and other intangible assets related to Logan Circle, (ii) our consolidation of FCF and Logan Circle, (iii) an increase in allowances for potentially uncollectible expense reimbursements in connection with a certain fund experiencing liquidity shortfalls, (iv) a net reversal of an allowance for potentially uncollectible management fees, primarily in connection with the resolution of liquidity and valuation shortfalls within a certain fund, which was recognized during the nine months ended September 30, 2010, and (v) a net increase in other general and administrative expenses.

*Three months ended September 30*

Expenses were \$500.6 million for the three months ended September 30, 2011, an increase of \$43.0 million, compared to \$457.6 million for the three months ended September 30, 2010. The increase was primarily attributable to an increase of \$39.6 million in principals agreement compensation and an increase of \$28.0 million in general, administrative and other expenses. These increases are partially offset by a decrease of \$25.7 million in compensation and benefits expense.

The increase in general, administrative and other expenses was primarily due to an impairment of goodwill and other intangible assets related to Logan Circle and a net increase in other general and administrative expenses. The increase in principals agreement compensation resulted from the acceleration of the agreement's maturity date from February 2012 to December 2011. Total compensation and benefits decreased primarily due to a net decrease in profit sharing expenses primarily related to our credit hedge funds, and a decrease of discretionary bonuses relative to the prior comparative period.

*Future Compensation Expense*

In future periods, we will further recognize non-cash compensation expense on our non-vested equity-based awards outstanding as of September 30, 2011 of \$297 million with a weighted average recognition period of 1.76 years. This does not include contingent amounts or amounts related to the Principals Agreement, which is discussed below.

*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 vesting period, which now ends on December 31, 2011. 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. As a result, management does not include this expense in any of its analyses of performance. When Fortress records this non-cash expense, it records a corresponding increase in capital.

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

### Table of Contents

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

	<b>Nine Months Ended September 30,</b>		<b>Three Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
GAAP Net Income (Loss)	\$ (883,201)	\$ (784,449)	\$ (381,905)	\$ (271,876)
Principals Agreement Compensation	751,749	712,101	279,623	239,975
GAAP Net Income (Loss) Excluding Principals Agreement Compensation	\$ (131,452)	\$ (72,348)	\$ (102,282)	\$ (31,901)

### Other Income (Loss)

#### *Nine months ended September 30*

Other Income (Loss) was (\$0.5) million for the nine months ended September 30, 2011, a net decrease of \$34.4 million, compared to \$33.9 million for the nine months ended September 30, 2010. The change was primarily due to an decrease in earnings from equity method investees with respect to our investments in our private equity funds, liquid hedge funds and credit hedge funds for the nine months ended September 30, 2011 relative to the prior comparative period, and an increase in net unrealized losses primarily related to our direct investment in GAGFAH and our investment in the options of one of our Castles.

#### *Three months ended September 30*

Other Income (Loss) was (\$79.7) million for the three months ended September 30, 2011, a net decrease of \$98.7 million, compared to \$19.0 million for the three months ended September 30, 2010. The change was primarily due to a decrease in earnings from equity method investees with respect to our investments in our private equity funds, liquid hedge funds, credit hedge funds and credit PE funds for the three months ended September 30, 2011 relative to the prior comparative period, and unrealized net losses for the three months ended September 30, 2011 primarily related to our direct investment in GAGFAH and our investment in the options of one of our Castles.

### 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.

For the nine months ended September 30, 2011 and 2010, Fortress recognized income tax expense (benefit) of \$24.5 million and \$4.6 million, respectively. The primary reason for the changes in income tax expense (benefit) are (i) changes in the mix of businesses producing income, which may be subject to tax at different rates, and related changes in our structure, (ii) changes in the forecasts of annual taxable income which

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

are used to calculate the tax provision, and (iii) the tax impact of RSUs and RPU's which vested and were delivered at a value substantially less than their original value, with this impact being the most significant during the first nine months of 2011. The deferred tax asset is further discussed under **Critical Accounting Policies** below.

### **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 one senior employee) and income tax expense.

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

### Table of Contents

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

The following table presents our results of operations for our private equity funds segment:

	Nine Months Ended September 30,		2011 vs. 2010	Three Months Ended September 30,		2011 vs. 2010
	2011	2010	\$	2011	2010	\$
Segment revenues						
Management Fees	\$ 101,443	\$ 102,705	\$ (1,262)	\$ 30,333	\$ 36,160	\$ (5,827)
Incentive Income	(1,748)	5,436	(7,184)	(3,077)	5,436	(8,513)
Segment revenues total	\$ 99,695	\$ 108,141	\$ (8,446)	\$ 27,256	\$ 41,596	\$ (14,340)
Pre-tax distributable earnings	\$ 69,878	\$ 79,670	\$ (9,792)	\$ 19,952	\$ 30,239	\$ (10,287)

#### *Nine months ended September 30*

Pre-tax distributable earnings decreased by \$9.8 million primarily due to:

#### *Revenues*

Management fees were \$101.4 million for the nine months ended September 30, 2011, a net decrease of \$1.3 million, compared to \$102.7 million for the nine months ended September 30, 2010. Management fees decreased \$1.3 million as a result of (i) a decrease of \$6.2 million due to the reset of Fund V, Fund V Coinvestment and FECEI upon expiration of their respective capital commitment periods, (ii) a decrease of \$1.1 million in management fees primarily from Fund I and Fund II, which are no longer subject to management fees, and (iii) a net decrease of \$1.0 million in management fees primarily as a result of a net decrease in the market values of certain portfolio companies below their invested capital in prior periods, which impacted the computation of management fees for the nine months ended September 30, 2011. These decreases were partially offset by an increase of \$7.0 million in Fund IV, Fund IV Coinvestment and FHIF management fees primarily due to a net increase in market values of certain portfolio companies which were below their invested capital in prior periods, which impacted the computation of management fees for the nine months ended September 30, 2011.

Incentive income was (\$1.7) million for the nine months ended September 30, 2011, a net decrease of \$7.2 million, compared to \$5.4 million of incentive income recognized for the nine months ended September 30, 2010. Incentive income decreased \$7.2 million as a result of (i) a \$4.5 million reserve for the potential clawback of incentive income for Fund II which was recognized in 2011 and (ii) a \$2.6 million decrease in incentive income due to lower realization events for Fund I.

*Expenses*

Expenses were \$29.8 million for the nine months ended September 30, 2011, a net increase of \$1.3 million, compared to \$28.5 million for the nine months ended September 30, 2010. The net increase of \$1.3 million in operating expenses was primarily attributable to (i) a net increase of \$6.0 million in general and administrative expenses, primarily related to an allowance for uncollectable amounts due from one of our private equity funds, and (ii) a net increase of \$0.1 million in compensation and benefits expense. These increases were partially offset by (i) a decrease of \$2.6 million in profit sharing compensation expense primarily related to the incentive income reserve for potential clawback for Fund II and the decrease in incentive income for Fund I and (ii) a decrease of \$2.4 million in corporate allocable expenses.

*Three months ended September 30*

Pre-tax distributable earnings decreased by \$10.3 million primarily due to:

*Revenues*

Management fees were \$30.3 million for the three months ended September 30, 2011, a net decrease of \$5.8 million, compared to \$36.2 million for the three months ended September 30, 2010. Management fees decreased \$5.8 million as a result of (i) a decrease of \$6.2 million due to the reset of Fund V, Fund V Coinvestment and FECl upon expiration of their respective capital commitment periods and (ii) a decrease of \$0.8 million in management fees primarily from Fund II, which is no longer subject to management fees. These decreases were partially offset by a net increase of \$1.1 million primarily due to a net increase in market values of certain portfolio companies held by Fund IV, Fund IV Coinvestment and

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

### Table of Contents

FHIF which were below their invested capital in prior periods, which impacted the computation of management fees for the three months ended September 30, 2011.

Incentive income was (\$3.1) million for the three months ended September 30, 2011, a net decrease of \$8.5 million, compared to \$5.4 of million incentive income recognized for the three months ended September 30, 2010. Incentive income decreased \$8.5 million as a result of (i) a \$4.5 million reserve for the potential clawback of incentive income for Fund II which was recognized in 2011 and (ii) a \$4.0 million decrease in incentive income due to lower realization events for Fund I.

### *Expenses*

Expenses were \$7.3 million for the three months ended September 30, 2011, a net decrease of \$4.1 million, compared to \$11.4 million for the three months ended September 30, 2010. The net decrease of \$4.1 million in operating expenses was primarily attributable to (i) a decrease of \$3.1 million in profit sharing compensation expense primarily related to the incentive income reserve for potential clawback for Fund II and the decrease in incentive income for Fund I, (ii) a decrease of \$0.8 million in corporate allocable expenses, and (iii) a net decrease of \$0.7 million in compensation and benefits expense. These decreases were partially offset by a net increase of \$0.2 million in general and administrative expenses.

### Publicly Traded Alternative Investment Vehicles ( Castles )

The following table presents our results of operations for our Castles segment:

	Nine Months Ended September 30,		2011 vs. 2010	Three Months Ended September 30,		2011 vs. 2010
	2011	2010	\$	2011	2010	\$
Segment revenues						
Management Fees	\$ 39,542	\$ 35,856	\$ 3,686	\$ 13,819	\$ 11,878	\$ 1,941
Incentive Income						
Segment revenues total	\$ 39,542	\$ 35,856	\$ 3,686	\$ 13,819	\$ 11,878	\$ 1,941
Pre-tax distributable earnings	\$ 19,375	\$ 13,338	\$ 6,037	\$ 7,630	\$ 4,181	\$ 3,449

### *Nine months ended September 30*

Pre-tax distributable earnings increased by \$6.0 million primarily due to:

### *Revenues*

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

Management fees were \$39.5 million for the nine months ended September 30, 2011, a net increase of \$3.7 million, compared to \$35.9 million for the nine months ended September 30, 2010. Management fees increased \$3.7 million as a result of (i) a \$1.7 million increase due to changes in foreign currency exchange rates, (ii) a \$1.7 million increase in management fees from certain investments within the Castles and (iii) a \$0.3 million increase due to an increase in Newcastle AUM resulting from their equity raises in 2011.

### *Expenses*

Expenses were \$20.1 million for the nine months ended September 30, 2011, a net decrease of \$2.5 million, compared to \$22.6 million for the nine months ended September 30, 2010. The net decrease of \$2.5 million in expenses was primarily attributable to a decrease in allocable corporate expenses primarily as a result of a decrease in overall corporate expenses and a decrease in average headcount within the Castles.

### *Three months ended September 30*

Pre-tax distributable earnings increased by \$3.4 million primarily due to:

### *Revenues*

Management fees were \$13.8 million for the three months ended September 30, 2011, a net increase of \$1.9 million, compared to \$11.9 million for the three months ended September 30, 2010. Management fees increased \$1.9 million as a result of (i) a \$0.5 million increase due to changes in foreign currency exchange rates, (ii) a \$1.1 million increase in management fees from certain investments within the Castles and (iii) a \$0.3 million increase due to an increase in Newcastle AUM resulting from their equity raises in 2011.

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

### Table of Contents

#### *Expenses*

Expenses were \$6.2 million for the three months ended September 30, 2011, a net decrease of \$1.5 million, compared to \$7.7 million for the three months ended September 30, 2010. The net decrease of \$1.5 million in expenses was primarily attributable to (i) a \$1.1 million decrease in allocable corporate expenses primarily as a result of a decrease in overall corporate expenses and a decrease in average headcount within the Castles and (ii) a \$0.4 million net decrease in compensation and benefits and general and administrative expenses.

#### Liquid Hedge Funds

The following table presents our results of operations for our liquid hedge funds segment:

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2011	2010	2011 vs. 2010	2011	2010	2011 vs. 2010
Management Fees	\$ 83,859	\$ 72,485	\$ 11,374	\$ 27,937	\$ 24,494	\$ 3,443
Incentive Income	4,526	26,119	(21,593)	1,354	21,292	(19,938)
Segment revenues - total	\$ 88,385	\$ 98,604	\$ (10,219)	\$ 29,291	\$ 45,786	\$ (16,495)
Pre-tax distributable earnings	\$ 14,291	\$ 32,171	\$ (17,880)	\$ 5,601	\$ 19,331	\$ (13,730)

#### *Nine months ended September 30*

Pre-tax distributable earnings decreased by \$17.9 million primarily due to:

#### *Revenues*

Management fees were \$83.9 million for the nine months ended September 30, 2011, a net increase of \$11.4 million, compared to \$72.5 million for the nine months ended September 30, 2010. Management fees increased \$11.4 million primarily due to net increases of \$12.1 million and \$1.0 million in management fees from the Fortress Macro Funds (including related managed accounts) and Fortress Commodities Funds (including related managed accounts), respectively, primarily as a result of net capital raises, and an increase of \$1.3 million in management fees from the Fortress Asia Macro Fund, which launched in March 2011. These increases in management fees were partially offset by net decreases of \$2.4 million and \$0.6 million in management fees from the Drawbridge Global Macro Funds and Fortress Partners Funds, respectively, primarily as a result of a decrease in management fees from the Drawbridge Global Macro Fund SPV, which is no longer subject to management fees as of July 31, 2010, and net capital outflows.

Incentive income, which is determined on a fund by-fund basis, was \$4.5 million for the nine months ended September 30, 2011, a net decrease of \$21.6 million, compared to \$26.1 million for the nine months ended September 30, 2010. Incentive income decreased \$21.6 million primarily

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

due to net decreases of \$23.4 million and \$1.1 million in the incentive income generated by the Fortress Macro Funds (including related managed accounts) and Fortress Partners Funds, respectively, primarily due to negative 2011 performance bringing nearly all capital eligible for incentive income below its respective high water mark, as compared to the prior comparative period. These decreases to incentive income were partially offset by a net increase of \$2.9 million in the incentive income generated by Fortress Commodities Funds (including related managed accounts) primarily due to incentive income crystallized in 2011 and a higher proportion of capital that was eligible for incentive income as certain capital met or exceeded its high water mark in the third quarter of 2011 and generated subsequent positive performance.

### *Expenses*

Expenses were \$74.1 million for the nine months ended September 30, 2011, a net increase of \$7.7 million, compared to \$66.4 million for the nine months ended September 30, 2010. The increase of \$7.7 million in expenses was primarily attributable to (i) an increase of \$8.0 million in compensation and benefits, which includes an increase of \$3.8 million in profit sharing compensation expense, partially offset by (ii) a net decrease of \$0.3 million in general and administrative and allocable expenses.

### *Three months ended September 30*

Pre-tax distributable earnings decreased by \$13.7 million primarily due to:

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

### Table of Contents

#### *Revenues*

Management fees were \$27.9 million for the three months ended September 30, 2011, a net increase of \$3.4 million, compared to \$24.5 million for the three months ended September 30, 2010. Management fees increased \$3.4 million primarily due to a net increase of \$3.0 million in management fees from the Fortress Macro Funds (including related managed accounts), primarily as a result of net capital raises, and an increase of \$0.9 million in management fees from the Fortress Asia Macro Fund, which launched in March 2011. These increases in management fees were partially offset by net decreases of \$0.3 million and \$0.2 million in management fees from the Drawbridge Global Macro Funds and Fortress Partners Funds, respectively, primarily as a result of a decrease in management fees from the Drawbridge Global Macro Fund SPV, which is no longer subject to management fees as of July 31, 2010, and net capital outflows.

Incentive income, which is determined on a fund by-fund basis, was \$1.4 million for the three months ended September 30, 2011, a net decrease of \$19.9 million, compared to \$21.3 million for the three months ended September 30, 2010. Incentive income decreased \$19.9 million primarily due to net decreases of \$20.5 million and \$0.8 million in the incentive income generated by the Fortress Macro Funds (including related managed accounts) and Fortress Partners Funds, respectively, primarily due to negative 2011 performance bringing nearly all capital eligible for incentive income below its respective high water mark, as compared to the prior comparative period. These decreases to incentive income were partially offset by a net increase of \$1.5 million in the incentive income generated by Fortress Commodities Funds (including related managed accounts) primarily as a result of a higher proportion of capital being eligible for incentive income as certain capital met or exceeded its high water mark in the third quarter of 2011 and generated subsequent positive performance.

#### *Expenses*

Expenses were \$23.7 million for the three months ended September 30, 2011, a net decrease of \$2.8 million, compared to \$26.5 million for the three months ended September 30, 2010. The decrease of \$2.8 million in expenses was primarily attributable to (i) a decrease of \$3.0 million in compensation and benefits, which includes a decrease of \$1.3 million in profit sharing compensation expense, partially offset by (ii) a net increase of \$0.2 million in general and administrative and allocable expenses.

### Credit Hedge Funds

The following table presents our results of operations for our credit hedge funds segment:

	Nine Months Ended September 30,		2011 vs. 2010	Three Months Ended September 30,		2011 vs. 2010
	2011	2010	\$	2011	2010	\$
Segment revenues						
Management Fees	\$ 96,122	\$ 94,691	\$ 1,431	\$ 34,919	\$ 27,778	\$ 7,141
Incentive Income	49,923	52,397	(2,474)	(4,274)	39,457	(43,731)
Segment revenues total	\$ 146,045	\$ 147,088	\$ (1,043)	\$ 30,645	\$ 67,235	\$ (36,590)
Pre-tax distributable earnings	\$ 27,628	\$ 41,149	\$ (13,521)	\$ (1,788)	\$ 15,551	\$ (17,339)

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

*Nine months ended September 30*

Pre-tax distributable earnings decreased by \$13.5 million primarily due to:

### *Revenues*

Management fees were \$96.1 million for the nine months ended September 30, 2011, a net increase of \$1.4 million, compared to \$94.7 million for the nine months ended September 30, 2010. Management fees increased \$1.4 million primarily due to (i) an increase of \$14.7 million in management fees from an advisory agreement which commenced in the first quarter of 2011 and was concluded in the third quarter of 2011, (ii) an increase of \$1.7 million in management fees from the Worden Funds, which launched in 2010, and (iii) a \$0.7 million net increase in management fees for the Drawbridge Special Opportunities Fund primarily as a result of capital raises and positive performance partially offset by capital distributions. These increases in management fees were partially offset by a \$15.7 million decrease in management fees from the Value Recovery Funds and related assets, of which \$9.8 million relates to the recognition in the second quarter of 2010 of management fees which were previously deemed potentially uncollectible.

Incentive income, which is determined on a fund by-fund basis, was \$49.9 million for the nine months ended September 30, 2011, a net decrease of \$2.5 million, compared to \$52.4 million for the nine months ended September 30, 2010. Incentive income decreased \$2.5 million primarily due to (i) a \$5.4 million decrease in incentive income from a third party account whose investments were fully realized in 2010 and (ii) a \$0.7 million decrease in incentive income generated by the

Table of Contents

Worden Funds. These decreases were partially offset by a net increase of \$3.7 million in incentive income from the Drawbridge Special Opportunities Funds due to an increase in profit eligible for incentive income as the funds met or exceeded their high water marks in 2010 and generated subsequent positive performance.

*Expenses*

Expenses were \$118.4 million for the nine months ended September 30, 2011, a net increase of \$12.5 million, compared to \$105.9 million for the nine months ended September 30, 2010. The increase of \$12.5 million in expenses was primarily attributable to (i) an increase of \$6.8 million in compensation and benefits, which is net of a decrease of \$1.3 million in profit sharing compensation expense, and (ii) a net increase of \$5.7 million in general and administrative and allocable expenses, primarily related to the advisory agreement which commenced in the first quarter of 2011 and was concluded in the third quarter of 2011.

*Three months ended September 30*

Pre-tax distributable earnings decreased by \$17.3 million primarily due to:

*Revenues*

Management fees were \$34.9 million for the three months ended September 30, 2011, a net increase of \$7.1 million, compared to \$27.8 million for the three months ended September 30, 2010. Management fees increased \$7.1 million primarily due to (i) an increase of \$7.8 million in management fees from an advisory agreement which commenced in the first quarter of 2011 and was concluded in the third quarter of 2011, (ii) an increase of \$0.5 million in management fees from the Worden Funds, and (iii) a \$1.0 million net increase in management fees for the Drawbridge Special Opportunities Fund, primarily as a result of capital raises and positive performance partially offset by capital distributions. These increases in management fees were partially offset by a \$2.1 million decrease in management fees from the Value Recovery Funds and related assets.

Incentive income, which is determined on a fund by-fund basis, was (\$4.3) million for the three months ended September 30, 2011, a net decrease of \$43.7 million, compared to \$39.5 million for the three months ended September 30, 2010. Incentive income decreased \$43.7 million primarily due to decreases of \$39.8 million and \$3.9 million in incentive income from the Drawbridge Special Opportunities Funds and the Worden Funds, respectively, due to the reversal in the third quarter of 2011 of a portion of the incentive income recorded during the first half of 2011, as compared to the incentive income recorded in the prior comparative period.

*Expenses*

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

Expenses were \$32.4 million for the three months ended September 30, 2011, a net decrease of \$19.3 million, compared to \$51.7 million for the three months ended September 30, 2010. The decrease of \$19.3 million in expenses was primarily attributable to (i) a decrease of \$23.2 million in compensation and benefits, which includes a decrease of \$19.4 million in profit sharing compensation expense, partially offset by (ii) a net increase of \$3.9 million in general and administrative and allocable expenses, primarily related to the advisory agreement which commenced in the first quarter of 2011 and was concluded in the third quarter of 2011.

### Credit PE Funds

The following table presents our results of operations for our credit PE segment:

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2011	2010	2011 vs. 2010	2011	2010	2011 vs. 2010
Management Fees	\$ 52,187	\$ 32,171	\$ 20,016	\$ 19,551	\$ 10,857	\$ 8,694
Incentive Income	99,666	140,845	(41,179)	19,813	9,299	10,514
Segment revenues - total	\$ 151,853	\$ 173,016	\$ (21,163)	\$ 39,364	\$ 20,156	\$ 19,208
Pre-tax distributable earnings	\$ 80,776	\$ 82,067	\$ (1,291)	\$ 23,595	\$ 7,277	\$ 16,318

*Nine months ended September 30*

Pre-tax distributable earnings decreased by \$1.3 million primarily due to:

Table of Contents

*Revenues*

Management fees were \$52.2 million for the nine months ended September 30, 2011, a net increase of \$20.0 million, compared to \$32.2 million for the nine months ended September 30, 2010. Management fees increased by \$20.0 million primarily due to a \$22.3 million increase in management fees attributable to net capital calls or commitments made after 2009, most notably by Credit Opportunities Fund, Credit Opportunities Fund II, Life Settlements Fund, Global Opportunities Fund and a third party account we manage. These increases in management fees were partially offset by (i) a net decrease of \$1.7 million in management fees primarily due to the Japan Opportunities Fund which had a management fee catch-up in 2010 for new investors who were admitted in subsequent closings of the fund, and (ii) a \$0.6 million decrease in management fees attributable to net capital distributions by the Long Dated Value Funds and Assets Overflow Fund.

Incentive income was \$99.7 million for the nine months ended September 30, 2011, a net decrease of \$41.2 million, compared to \$140.8 million for the nine months ended September 30, 2010. Incentive income decreased \$41.2 million primarily due to a \$59.8 million decrease in incentive income primarily as a result of a decrease in distributions generated by realization events within Credit Opportunities Fund and a third party account we manage during the nine months ended September 30, 2011 as compared to the prior comparative period. This decrease in incentive income was partially offset by an increase of \$18.6 million in incentive income generated primarily from the Japan Opportunities Fund, Credit Opportunities Fund II, FCO MA II, Real Assets Fund, Assts Overflow Fund and Long Dated Value Fund III for the nine months ended September 30, 2011 as compared to the prior comparative period.

*Expenses*

Expenses were \$71.1 million for the nine months ended September 30, 2011, a net decrease of \$19.8 million, compared to \$90.9 million for the nine months ended September 30, 2010. The net decrease of \$19.8 million in operating expenses was primarily attributable to a decrease of \$24.3 million in compensation and benefits expense, primarily related to profit sharing compensation expense. This decrease was partially offset by a net increase of \$4.5 million in general and administrative and allocable expenses.

*Three months ended September 30*

Pre-tax distributable earnings increased by \$16.3 million primarily due to:

*Revenues*

Management fees were \$19.6 million for the three months ended September 30, 2011, a net increase of \$8.7 million, compared to \$10.9 million for the three months ended September 30, 2010. Management fees increased by \$8.7 million primarily due to (i) a \$9.0 million increase in management fees attributable to net capital calls or commitments made after the second quarter of 2010, most notably by Credit Opportunities Fund, Credit Opportunities Fund II, Life Settlements Fund, Global Opportunities Fund and a third party account we manage and (ii) an increase of \$0.2 million attributable to the Japan Opportunities Fund as a result of changes in foreign currency exchange rates. These increases were partially offset by a \$0.4 million decrease in management fees attributable to net capital distributions by the Long Dated Value Funds and Assets

Overflow Fund.

Incentive income was \$19.8 million for the three months ended September 30, 2011, a net increase of \$10.5 million, compared to \$9.3 million for the three months ended September 30, 2010. Incentive income increased \$10.5 million primarily as a result of an \$11.7 million increase in incentive income generated primarily from the Japan Opportunities Fund, Credit Opportunities Fund II, FCO MA II, Long Dated Value Fund III, Real Assets Fund and a third party account we manage for the three months ended September 30, 2011 as compared to the prior comparative period. These increases were partially offset by a \$1.2 million decrease in incentive income generated within Credit Opportunities Fund during the three months ended September 30, 2011 as compared to the prior comparative period.

*Expenses*

Expenses were \$15.8 million for the three months ended September 30, 2011, a net increase of \$2.9 million, compared to \$12.9 million for the three months ended September 30, 2010. The net increase of \$2.9 million in operating expenses was primarily attributable to an increase of \$2.7 million in compensation and benefits expense, primarily related to profit sharing compensation expense, and a net increase of \$0.2 million in general and administrative and allocable expenses.

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

### Table of Contents

### Principal Investments

The following table presents our results of operations for our principal investments segment:

	Nine Months Ended September 30,		2011 vs. 2010	Three Months Ended September 30,		2011 vs. 2010
	2011	2010	\$	2011	2010	\$
Pre-tax distributable earnings (loss)	\$ (7,473)	\$ 10,860	\$ (18,333)	\$ (7,944)	\$ 6,540	\$ (14,484)

#### *Nine months ended September 30*

Pre-tax distributable earnings decreased by \$18.3 million primarily due to:

- a \$2.1 million increase in net investment income primarily as a result of a decrease in recorded impairments of \$3.5 million and \$0.6 million with respect to our investments in our private equity funds and special investments in our hedge funds, respectively, for the nine months ended September 30, 2011 as compared to the prior comparative period. These decreases in recorded impairments were partially offset by the recording of \$2.0 million of impairments with respect to our investments in Eurocastle for the nine months ended September 30, 2011;
- an \$11.4 million decrease in net investment income from realizations and the performance of our investments in our funds. The \$11.4 million net decrease in investment income was due to a net decrease of \$1.1 million due to realization events in our credit PE funds, private equity funds, and special investments in our hedge funds and a net decrease of \$10.3 million attributable to our investments in our hedge funds for the nine months ended September 30, 2011 as compared to the prior comparative period;
- a \$2.9 million decrease in net investment income due to a net increase in interest expense primarily due to (i) an increase of \$4.2 million primarily due to an increase in the average interest rate paid as compared to the nine months ended September 30, 2010, partially offset by (ii) a decrease of \$1.3 million in the amortization of financing costs;
- a \$3.0 million decrease in net investment income due to a decrease in dividend income earned from our direct investment in GAGFAH common stock, partially offset by an increase in dividend income earned from our direct investment in Newcastle common stock; and
- a \$3.0 million decrease in net investment income due to the realized losses on our foreign currency hedges for the nine months ended September 30, 2011 as compared to the prior comparative period.

#### *Three months ended September 30*

Pre-tax distributable earnings decreased by \$14.5 million primarily due to:

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

- a \$1.8 million decrease in net investment income primarily as a result of recording \$2.0 million of impairments with respect to our investments in Eurocastle for the three months ended September 30, 2011. This increase in impairments was partially offset by a decrease in recorded impairments of \$0.2 million with respect to our special investments in our hedge funds for the three months ended September 30, 2011 as compared to the prior comparative period;
- a \$10.2 million decrease in net investment income from our investments in our funds. The \$10.2 million net decrease in investment income was due to a net decrease of \$0.4 million due to realization events in our credit PE funds, private equity funds, and special investments in our hedge funds and a net decrease of \$9.8 million attributable to our investments in our hedge funds for the three months ended September 30, 2011 as compared to the prior comparative period;
- a \$1.0 million decrease in net investment income due to a net increase in interest expense primarily due to (i) an increase of \$1.4 million primarily due to an increase in the average interest rate paid as compared to the three months ended September 30, 2010, partially offset by (ii) a decrease of \$0.4 million in the amortization of financing costs;
- a \$0.6 million decrease in net investment income due to a decrease in dividend income earned from our direct investment in GAGFAH common stock, partially offset by an increase in dividend income earned from our direct investment in Newcastle common stock; and
- a \$0.7 million decrease in net investment income due to a \$1.2 million decrease as a result of foreign currency translation adjustments, partially offset by \$0.5 million of realized losses on foreign currency hedges recorded for the three months ended September 30, 2010.

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

Table of Contents

The following table reflects all of our investments which are not marked to market through distributable earnings for segment reporting purposes as of September 30, 2011:

<b>Fund</b>	<b>Fortress Share of NAV (A)</b>	<b>Fortress Segment Cost Basis (B)</b>	<b>Excess (C)</b>	<b>(Deficit) (C)</b>
<b><u>Main Funds</u></b>				
Fund I	\$ 63	\$	\$ 63	\$ N/A
Fund II	1,095		1,095	N/A
Fund III and Fund III Coinvestment	9,565	5,038	4,527	N/A
Fund IV and Fund IV Coinvestment	105,111	79,575	25,536	N/A
Fund V and Fund V Coinvestment	136,453	74,082	62,371	N/A
Long Dated Value Funds	20,115	14,998	5,117	N/A
Real Assets Funds	24,303	14,835	9,468	N/A
Credit Opportunities Funds	47,438	33,212	14,288	(62)
Mortgage Opportunities Funds	4,138	330	3,808	N/A
Asia Funds (Japan Opportunity and Global Opportunities)	6,387	5,198	1,221	(32)
WWTAI	1,125	1,350	N/A	(225)
Real Estate Opportunities Fund	230	238	N/A	(8)
<b><u>Other Funds (combined)</u></b>				
GAGFAH (XETRA: GFJ)	6,096	2,880	3,216	N/A
Brookdale (NYSE: BKD)	17,130	8,136	8,994	N/A
Private investment #1	241,210	207,357	33,853	N/A
Private investment #2	94,731	43,866	50,865	N/A
<b><u>Castles</u></b>				
Eurocastle (EURONEXT: ECT)	81	81	N/A	N/A
Newcastle (NYSE: NCT)	4,175	667	3,508	N/A
<b><u>Other</u></b>				
Hedge fund side pocket investments	84,192	67,696	17,128	(632)
Direct investments	100,258	65,001	35,272	(15)
<b>Total</b>	<b>\$ 903,896</b>	<b>\$ 624,540</b>	<b>\$ 280,330</b>	<b>\$ (974)</b>

(A) Represents the net asset value ( NAV ) of Fortress 's investment in each fund. This is generally equal to its GAAP and segment carrying value.

(B) Represents Fortress 's cost basis in each investment for segment reporting purposes, which is net of any prior impairments taken for distributable earnings.

(C) Represents the difference between NAV and segment cost basis. If negative (a deficit), this represents potential future impairment. If positive (an excess), this represents unrealized gains which, if realized, will increase future distributable earnings.

Unallocated

Nine Months Ended September 30, 2011 vs. 2010      Three Months Ended September 30, 2011 vs. 2010

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

	2011		2010	\$	2011		2010	\$			
Pre-tax distributable earnings (loss)	\$ (12,197)	\$	(12,148)	\$	(49)	\$	(4,156)	\$	(5,443)	\$	1,287

*Nine months ended September 30*

Pre-tax distributable loss increased by less than \$0.1 million primarily due to:

- a \$6.2 million increase in management fees due to the Logan Circle acquisition in April 2010; offset by
- a \$6.2 million increase in operating and acquisition expenses primarily due to the Logan Circle acquisition in April 2010.

*Three months ended September 30*

Pre-tax distributable loss decreased by \$1.3 million primarily due to:

- a \$1.3 million decrease in operating expenses primarily due to a decrease in expenses related to Logan Circle for the three months ended September 30, 2011 as compared to the prior comparative period.

### **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.

Table of Contents

**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. The cash received from these investment returns is limited based on the liquidity terms of the respective funds; for instance, private equity funds generally only distribute cash upon investment realization events. Our primary uses of liquidity include operating expenses (which include compensation, rent and interest, among others), 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 funds. As of September 30, 2011, the receipt of approximately \$107.2 million of management fees had been deferred, of which \$12.0 million has been reserved by us, and the ultimate timing of their payment is currently uncertain. In addition, \$34.0 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. If these delinquencies 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 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 \$313.7 million at September 30, 2011, our available draws under our credit facility of \$53.9 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, such as EBITDA and Adjusted EBITDA as defined in our credit agreement) 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

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

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. 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 relative 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

Table of Contents

increases to operating costs. 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 September 30, 2011, 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.

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

### Table of Contents

Our capital commitments to our funds with outstanding commitments as of September 30, 2011 consisted of the following (in thousands).

	<b>Outstanding Commitment</b>
<b>Private Equity Funds</b>	
Fund II	\$ 566
Fund III Coinvestment	2
Fund IV	4,053
Fund IV Coinvestment	3
Fund V	6,143
Fund V Coinvestment	2
FRID	812
FHIF	8,993
FECI	1,551
WWTAI	6,150
<b>Credit PE Funds</b>	
Credit Opportunities Fund	12,228
Credit Opportunities Fund II	3,133
Credit Opportunities Fund III	600
FTS SIP L.P.	524
FCO MA LSS	927
FCO MA II	5,726
FCO MA Maple Leaf	3,337
Long Dated Value Fund I	460
Long Dated Value Fund II	1,747
Long Dated Value Fund III	165
LDVF Patent Fund	41
Real Assets Fund	21,150
Assets Overflow Fund	200
Japan Opportunity Fund	2,889
Net Lease Fund I	301
Global Opportunities Fund	3,452
Life Settlements Fund	92
Life Settlements Fund MA	61
Real Estate Opportunities Fund	512
Karols Development Co	5,272
Other	621
Total	\$ 91,713

### *Lease Obligations*

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

October 1 to December 31, 2011	\$ 5,311
2012	21,620
2013	21,357
2014	20,475
2015	18,877
2016	17,027

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

Thereafter		1,942
Total	\$	106,609

*Debt Obligations*

As of September 30, 2011, our debt obligations consisted of the amounts outstanding under our credit agreement, as described below.

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

### Table of Contents

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	September 30, 2011	
	September 30, 2011	December 31, 2010		Weighted Average Funding Cost (1)	Weighted Average Maturity (Years)
Credit Agreement (2)					
Revolving debt (3)	\$	\$	Oct 2013	0.00%	
Term loan	270,000	277,500	Oct 2015	6.09%	3.04
Total	\$ 270,000	\$ 277,500		6.09%	3.04

(1) The weighted average funding cost is calculated based on the contractual interest rate (utilizing the most recently reset LIBOR rate or the minimum rate, as applicable) plus the amortization of deferred financing costs. The most recently reset LIBOR rate was below the minimum of 1.75%.

(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 \$53.9 million was undrawn on the revolving debt facility as of September 30, 2011. The revolving debt facility includes a \$25 million letter of credit subfacility of which \$6.1 million was utilized.

Assuming no Free Cash Flow based required repayments, our outstanding debt matures as follows as of September 30, 2011 (in thousands).

October 1 - December 31, 2011	\$ 8,750
2012	35,000
2013	35,000
2014	35,000
2015	156,250
Total	\$ 270,000

Mandatory principal repayments of 50% of Free Cash Flow of each calendar year, up to a limit, as defined in the 2010 Credit Agreement, for each of the years 2011 through 2014 are required to be made in April of each subsequent year (2012 through 2015). Although these mandatory repayments are calculated based on annual Free Cash Flow, for the nine months ended September 30, 2011, the repayment which would be made, if such period were calculated by itself, is estimated to be \$63.8 million.

During the nine months ended September 30, 2011, the average face amount of our outstanding debt was approximately \$275.0 million and the highest face amount outstanding at one time during this period was \$277.5 million. During this period, we did not incur any new short-term borrowings.

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

As a result of our initial public offering and related transactions, secondary public offerings, and other transactions, FIG Asset Co. LLC lent aggregate excess proceeds of approximately \$371.1 million to FIG Corp., pursuant to a demand note. As of September 30, 2011, the outstanding balance was approximately \$323.6 million, including unpaid interest. This intercompany debt is eliminated in consolidation.

### *Covenants*

Fortress Operating Group is required to prepay the 2010 Credit Agreement upon the occurrence of certain events, including certain asset sales and other dispositions.

The events of default under the 2010 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 2010 Credit Agreement) with respect to our material funds. A default under this agreement would likely have a material, adverse impact on our liquidity.

The 2010 Credit Agreement contains customary representations and warranties and affirmative and negative covenants that, among other things, restrict the ability of Fortress to create or incur certain liens, incur or guarantee additional indebtedness, merge or consolidate with other companies or transfer all or substantially all of their respective assets, transfer or sell assets, make restricted payments, engage in transactions with affiliates and insiders, and incur restrictions on the payment of dividends or other distributions and certain other contractual restrictions. These covenants are subject to a number of limitations and exceptions set forth in the 2010 Credit Agreement. We were in compliance with all of these covenants as of September 30, 2011. In addition, Fortress Operating Group must not:

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

### Table of Contents

- Permit AUM (as defined in the 2010 Credit Agreement) to be less than \$25.0 billion as of the end of any calendar month;
- Permit the Consolidated Leverage Ratio (a measure of net outstanding debt compared to EBITDA, as defined in the 2010 Credit Agreement) to be greater than 2.75 to 1.0 as of the end of any fiscal quarter for the four quarter period ending on such date;
- Permit the Minimum Investment Assets Ratio (a measure of investments compared to outstanding debt, as defined in the 2010 Credit Agreement), as of the end of any fiscal quarter, to be less than 2.00 to 1.0 through December 31, 2012 or less than 2.25 to 1.0 thereafter; or
- Permit the Consolidated Fixed Charge Coverage Ratio (a measure of EBITDA after permitted tax distributions compared to required debt payments, or fixed charges, as defined in the 2010 Credit Agreement) to be: (i) if Net Funded Indebtedness (a measure of outstanding debt, as defined in the 2010 Credit Agreement) is greater than \$300 million, less than or equal to 2.25 to 1.0, (ii) if Net Funded Indebtedness is greater than \$250 million but less than or equal to \$300 million, less than or equal to 2.00 to 1.0 or (iii) if Net Funded Indebtedness is less than \$250 million, less than or equal to 1.75 to 1.00, as of the end of any fiscal quarter for the four quarter period ending on such date.

The following table sets forth the financial covenant requirements as of September 30, 2011.

	<b>September 30, 2011</b>		<b>Notes</b>
	<b>Requirement</b>	<b>Actual</b>	
AUM, as defined	≥ \$25,000	\$ 35,010	(A)
Consolidated Leverage Ratio	≤ 2.75	0.69	(B)
Minimum Investment Assets Ratio	≥ 2.00	4.35	(C)
Consolidated Fixed Charge Coverage Ratio	≥ 1.75	4.63	(B)

(A) Impacted by capital raised in funds, redemptions from funds, and valuations of fund investments. The AUM presented here is based on the definition contained in the credit agreement.

(B) The consolidated leverage ratio is equal to net debt, as defined, divided by the trailing four quarters EBITDA, as defined. The consolidated fixed charge coverage ratio is equal to the quotient of (A) the trailing four quarters EBITDA, as defined, less permitted tax distributions, as defined, divided by (B) the trailing four quarters required interest and principal payments made with respect to the 2010 Credit Agreement. 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.

<b>September 30, 2011</b>	
Outstanding debt	\$ 270.0
Plus: Outstanding letters of credit	6.1
Less: Cash (up to \$50 million)	(50.0)
Net debt	\$ 226.1

<b>Twelve Months Ended</b>	
<b>September 30, 2011</b>	
Fortress Operating Group GAAP net income (loss) after non-controlling interests	\$ (851.8)
Depreciation and amortization, interest expense and income taxes	74.6

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

Extraordinary or non-recurring gains and losses		
Incentive Income Adjustment		(14.7)
Other Income Adjustment		(102.1)
Compensation expenses recorded in connection with the assignment of Castle Options and Stock Based Compensation		1,220.2
Accrued employee profit sharing related to NIH incentive compensation minus cash payments made with respect to such employee profit sharing		
Income (loss) allocable to, or resulting from distributions to, the Principals (and one senior employee) or their assignees		
EBITDA	\$	326.2
Permitted tax distributions	\$	77.2
Fixed charges	\$	53.8

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

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

### Table of Contents

The foregoing summary is not complete and is qualified in its entirety by reference to the 2010 Credit Agreement, which is filed as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2010 and is incorporated by reference herein.

### *Dividends / Distributions*

During the nine months ended September 30, 2011, Fortress Operating Group declared distributions of \$21.4 million to the principals and a senior employee in connection with tax obligations.

Our board of directors has approved a revised dividend policy under which it will reinstate a quarterly dividend to Class A shareholders beginning in the fourth quarter of 2011. The dividend related to the fourth quarter of 2011 will be \$0.05 per share.

### *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.

As noted above, our board of directors recently approved a revised dividend policy. 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, if such a payment would violate the terms of our credit agreement, 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 \$121.2 million and \$218.4 million during the nine months ended September 30, 2011 and 2010, respectively.

Operating Activities Comparative

Cash received for management fees increased by \$64.1 million from \$309.7 million in 2010 to \$373.8 million in 2011. Management fees are based on average AUM, which increased from 2010 to 2011 (private equity funds decreased by less than (\$0.1) billion, Castles increased by \$0.2 billion, liquid hedge funds increased by \$0.7 billion, credit hedge funds decreased by (\$0.7) billion, and credit PE funds increased by \$2.0 billion) as a result of capital raising, including new fund formation, and returns, offset by redemptions, capital distributions and losses. However, approximately \$107.2 million of management fees were past due at September 30, 2011, as opposed to \$64.9 million at December 31, 2010, as discussed in Liquidity and Capital Resources above.

Incentive income is calculated as a percentage of profits earned by the Fortress Funds and managed accounts or is based on profitable realization events within private equity funds and credit PE funds and based on cash realizations in Value Recovery Funds. A \$47.0 million decrease in cash incentive income received was mainly due to reduced realizations within the credit PE funds in 2011.

Cash paid for compensation increased by \$114.9 million from the nine months ended September 30, 2010 compared to September 30, 2011. Bonuses and profit sharing payments are generally paid in January of the year following the year in which they are earned, so this change is primarily related to an increase in bonuses earned in 2010 compared to 2009.

Cash paid for interest increased approximately \$2.8 million primarily due to an increase in the weighted average interest rate to 5.75% in 2011 as compared to 2.78% in 2010. This was partially offset by a lower average debt balance of \$275.0 million in 2011 compared to \$370.5 million in 2010.

Cash received for tax refunds increased by \$8.2 million for the nine months ended September 30, 2011 compared to September 30, 2010.

Table of Contents

Investing Activities

Our net cash flow provided by (used in) investing activities was \$96.0 million and (\$18.0) million during the nine months ended September 30, 2011 and 2010, respectively. Our investing activities primarily included: (i) contributions to equity method investees of (\$69.9) million and (\$48.9) million during the nine months ended September 30, 2011 and 2010, respectively, (ii) distributions of capital from equity method investees of \$179.3 million and \$46.0 million during the nine months ended September 30, 2011 and 2010, respectively, and (iii) purchases of fixed assets, net of proceeds from the disposal of fixed assets, of (\$13.4) million and (\$1.6) million during the nine months ended September 30, 2011 and 2010, respectively. In addition, Fortress used a net \$13.5 million of cash during the nine months ended September 30, 2010 on acquisitions, primarily Logan Circle Partners, L.P.

Financing Activities

Our net cash flow provided by (used in) financing activities was (\$114.1) million and (\$163.9) million during the nine months ended September 30, 2011 and 2010, respectively. Our financing activities primarily included (i) distributions made to principals, including those classified within principals and others interests in consolidated subsidiaries, of (\$61.5) million and (\$55.3) million during these periods, respectively, (ii) distributions to employees and others related to their interests in consolidated subsidiaries of (\$58.2) million and (\$67.3) million during these periods, respectively, (iii) contributions from employees and others related to their interests in consolidated subsidiaries of \$13.1 million and \$0.1 million during these periods, respectively, and (iv) our borrowing and repayment activity.

**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. If, as a result of such analysis, Fortress were required to consolidate a fund, portfolio company, or related entity, it could have a material impact on our gross revenues, expenses, net income, assets, liabilities and total equity. However, we would not expect it to materially impact our net income, or equity, attributable to Class A shareholders.

*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

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

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. For certain funds, a portion (or all) of any incentive income distribution may be deemed a tax distribution. Tax distributions are not subject to contingencies. The determination of the amount of a distribution which represents a tax distribution is based on an estimate of both the amount of taxable income generated and the applicable tax rate. Estimates of taxable income are subject to significant judgment.

### 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.

### Table of Contents

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.

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 and Supplementary Data 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.

## Table of Contents

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 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.

## 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 verified 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.

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

## 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.

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

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

Table of Contents

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.

**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 September 30, 2011. As of September 30, 2011, revenues from our traditional asset management business are not material to our operations and are therefore not included in the analysis below.

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

Basis for Determining Fair Value	Private Equity Funds	Liquid Hedge Funds (B)		Credit Hedge Funds	Credit PE Funds	Total Investment Company Holdings
		Long	Short			
1. Quoted market prices	6%	32%	78%	1%	3%	5%
2. Other observable market parameters	4%	26%	22%	1%	0%	4%
3A. Third party pricing sources with significant unobservable market parameters (A)	6%	31%	0%	97%	58%	45%
3B. Internal models with significant unobservable market parameters	84%	11%	0%	1%	39%	46%
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.

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

(B) The level 3A and 3B investments within the liquid hedge funds segment primarily related to the illiquid SPV and sidepocket investments within the Drawbridge Global Macro Funds, as well as the Fortress Partners Funds, which were transferred to this segment in 2011.

As of September 30, 2011, \$10.6 billion of investments in our private equity funds, \$0.4 billion of investments in our liquid hedge funds, \$0.1 billion of investments in our credit hedge funds, and \$2.4 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 nine months ended September 30, 2011, consistent with the table above:

	<b>Private Equity Funds</b>	<b>Liquid Hedge Funds</b>	<b>Credit Hedge Funds</b>	<b>Credit PE Funds</b>
Management fees, per annum on a prospective basis	\$4.0 million or (6.8 million) (A)	\$1.7 million	\$14.6 million	\$0.4 million or (\$1.9 million) (A)
Incentive income	N/A (B)	N/A (C)	N/A (C)	N/A (B)
Earnings from equity method investees	\$56.2 million	\$11.6 million	\$3.0 million	\$9.6 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, for investments in non-publicly traded securities, 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 September 30, 2011, \$3.7 billion of such portfolio companies valued at level 3 (A or B) were carried at or below their invested capital and are in funds which are no longer in their commitment period. Management fees are generally calculated as of certain reset

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

### Table of Contents

dates. The amounts disclosed show what the estimated effects would be to management fees over the next year assuming September 30, 2011 is the current reset date.

(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.

### *Income Taxes*

FIG Corp. has recorded a significant deferred tax asset, primarily in connection with our initial public offering and related transactions. 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. 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 federal taxable income for historical periods before deductions relating to the establishment of the deferred tax assets, other than deferred tax assets arising from equity-based compensation, as well as the average of ordinary income 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	\$	24.8
2010	\$	77.6
2011 - 2015: Average Required	\$	57.7
2016 - 2021: Average Required	\$	81.0

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

Based on the effects of the continuing challenging market 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 and Supplementary Data 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.

Table of Contents

*Equity-Based Compensation*

We currently have several categories of equity-based compensation which are described in Note 7 to Part I, Item 1, Financial Statements and Supplementary Data Equity-Based and Other 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.

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 did not have sufficient historical share performance to use our own historical volatility, adjusted for management's judgment regarding our expected volatility. Since our initial public offering 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; and
- 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.

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 decrease compensation expense related to RSUs with no service conditions since the discount for delayed delivery 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 and (ii) decrease compensation expense related to RSUs with no service conditions since the discount for delayed delivery 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 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 our financial position, results of operations or liquidity.

In May 2011, the FASB issued new guidance regarding the measurement and disclosure of fair value, which will become effective for Fortress on January 1, 2012. Fortress does not expect this guidance to have a material direct impact on its financial position, results of operations or liquidity. Fortress has not yet completed its assessment of the potential impact of this guidance on the fair values reported by its funds.

Table of Contents

The FASB has recently issued or discussed a number of proposed standards on such topics as consolidation, the definition of an investment company, financial statement presentation, revenue recognition, leases, financial instruments, hedging, and contingencies. Some of the proposed changes are significant and could have a material impact on Fortress's financial reporting. Fortress has not yet fully evaluated the potential impact of these proposals, but will make such an evaluation as the standards are finalized.

**Market Risks**

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.

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements.

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

**Contractual Obligations**

As of September 30, 2011, 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 \$968.3 million as of December 31, 2010 to \$929.3 million as of September 30, 2011.

Our debt obligations payable decreased from \$338.3 million as of December 31, 2010 to \$318.4 million as of September 30, 2011, including estimates for interest payments.

The amount of clawback that would be due based on a liquidation of the related Fortress Funds at their net asset value as of September 30, 2011, which we refer to as intrinsic clawback, was \$100.4 million as compared to \$93.6 million at December 31, 2010.

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

Our estimated liability under the tax receivable agreement decreased from \$295.5 million at December 31, 2010 to \$282.2 million at September 30, 2011, primarily as a result of payments made.

Our outstanding capital commitments, including our commitments to our funds, have decreased from \$101.9 million as of December 31, 2010 to \$91.7 million as of September 30, 2011.

Our operating lease agreement obligations increased from \$100.2 million at December 31, 2010 to \$106.6 million at September 30, 2011.

Table of Contents

**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 September 30, 2011, revenues from our traditional asset management business are not material to our operations and are therefore not included in the analysis below.

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 company runs its own investment and risk management process.

- 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 various risk management techniques to analyze risk related to specific assets or portfolios, as well as fund-wide risks.

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 September 30, 2011 (in thousands):

Assets		
Investments	\$	1,061,460
Liabilities		
Debt obligations payable	\$	270,000

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

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 September 30, 2011, approximately 40% 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

Table of Contents

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 and certain advisory engagements, management fees are based on their NAV, which in turn is dependent on the estimated fair values of their investments and non-investment assets and liabilities of the funds. For the Value Recovery Funds and advisory engagements, management fees are based on realizations, which are not dependent on current estimated fair value, and, in some cases, a fixed fee. 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 the values of the funds' investments which, in turn, are 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 the values of its investments, (ii) the period over which the Fortress Funds apply performance criteria (i.e., quarterly, annually 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 September 30, 2011 would increase or decrease future incentive income by \$176.7 million or (\$107.8) million, respectively; however, this would have no effect on our current reported financial condition or results of operations.
- 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 generally 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 certain items (for example, the unrealized gain or loss on non-hedge derivatives).
- 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 September 30, 2011 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

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

realizations exceed an agreed 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.

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

Table of Contents

*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 September 30, 2011 (in millions).

	GAAP Revenues			10% Positive Change		
	Management Fees (B)	Incentive Income	Earnings from Equity Method Investees (C)	Management Fees (B)	Incentive Income	Investment Income
Private Equity						
Funds	\$ 5.3	\$ N/A(E)	\$ 61.8	\$ 5.3	\$ N/A(E)	\$ N/A
Castles (D)	N/A	N/A	N/A	N/A	N/A	N/A
Liquid Hedge Funds	10.2	N/A(G)	20.0	10.2	35.1	11.7
Credit						
Hedge Funds	10.3	N/A(G)	2.0	10.3	65.0	1.9
PE Funds	0.4	N/A(E)	9.9	0.4	N/A(E)	N/A
Total	\$ 26.2	\$	\$ 93.7	\$ 26.2	\$ 100.1	\$ 13.6

	GAAP Revenues			10% Negative Change		
	Management Fees (B)	Incentive Income	Earnings from Equity Method Investees (C)	Management Fees (B)	Incentive Income	Investment Income
Private Equity						
Funds	\$ (8.1)	\$ N/A(E)	\$ (61.8)	\$ (8.1)	\$ N/A(E)(F)	\$ N/A(F)
Castles (D)	N/A	N/A	N/A	N/A	N/A	N/A(F)
Liquid Hedge Funds	(10.2)	N/A(G)	(20.0)	(10.2)	(1.2)	(11.7)
Credit						
Hedge Funds	(10.3)	N/A(G)	(2.0)	(10.3)	(44.9)	(1.9)
PE Funds	(2.0)	N/A(E)	(9.9)	(2.0)	N/A(E)(F)	N/A(F)
Total	\$ (30.6)	\$	\$ (93.7)	\$ (30.6)	\$ (46.1)	\$ (13.6)

(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 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, \$4.0 billion of such private equity fund or credit PE fund portfolio companies were carried at or below their invested capital and are 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 \$3.5 million.

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

(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 \$1.9 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.

Table of Contents

*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 September 30, 2011, we estimate that interest expense relating to variable rate debt obligations payable would be unchanged on an annual basis in the event interest rates were to increase by one percentage point, due to the benchmark rate on the debt being below the minimum rate.

*Exchange Rate Risk*

Our investments in Eurocastle, GAGFAH, Karols Development Co., and certain Japanese entities are directly exposed to foreign exchange risk. As of September 30, 2011, we had a \$0.1 million investment in Eurocastle and a \$35.9 million investment in GAGFAH, including foreign exchange option contracts, which are accounted for at fair value. We also had a \$24.7 million investment in Karols Development Co. and \$6.3 million of investments in certain Japanese entities. In the event of a 10% change in the applicable foreign exchange rate against the U.S. dollar on September 30, 2011, we estimate the gains and losses for the nine months ended September 30, 2011 in relation to the value of the investments would increase or decrease by approximately \$3.8 million. In addition, we held \$32.3 million of foreign-denominated cash as of September 30, 2011.

**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 generally 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 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. Our current credit agreement includes financial covenants that we:

- not exceed a total leverage ratio or a fixed charge coverage ratio;
- maintain a minimum AUM; and
- maintain a minimum ratio of investment assets to funded indebtedness.

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

The leverage ratio, fixed charge coverage ratio and minimum investment assets ratio covenants are tested as of the end of each fiscal quarter, while the AUM covenant is tested as of the end of each calendar month. 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; our fixed charge coverage ratio fluctuates depending upon various revenues and expenses relative to our outstanding funded indebtedness and cash on hand; and the value of our AUM and investment assets fluctuates due to a variety of factors, including mark-to-market valuations of certain assets, other market factors, and, in the case of AUM, our net capital raised or returned. 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 were adversely affected by the recession. 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, and the occurrence of a number of events that would constitute an event of default under the agreement.

In addition, our credit agreement requires that we make significant amortization payments prior to the maturity of the facilities in October 2015, as further described in Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Debt Obligations. Making these payments will require a significant amount of our available cash flow, which 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 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 and to declare all borrowings outstanding,

Table of Contents

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 accelerated, we might 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.

In addition, our revolving credit facility matures in October 2013, which is two years before our term loan facility matures in October 2015. As a result, we may need to refinance our revolving credit facility prior to the maturity of our term loan facility. The terms of any new revolving credit facility or replacement financing may be less favorable to us than the terms of our existing credit agreement.

**We depend on Messrs. Briger, Edens, Kauffman, Nardone and Novogratz, 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 an employment agreement with us, which extends to January 1, 2017. 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 (as amended in August 2011) among themselves, which provides that, in the event a principal voluntarily terminates his employment with us for any reason prior to December 31, 2011, 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 further amended by the principals. We and our shareholders 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 (other than our principals) to be actively involved in the business provides investors with the right to redeem their investment 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 of Mr. Novogratz or his inability to perform his services for 90 days could result in substantial withdrawal requests from investors in our Fortress Macro funds. The loss of the co-chief investment officer of the Fortress Macro funds, Adam Levinson, also could result in withdrawal requests. Substantial withdrawals would have a material adverse effect on the Fortress Macro funds and us by reducing our management fees from those funds. Further, such withdrawals could lead possibly to the liquidation of the funds and a corresponding elimination of our management fees and potential to earn

Table of Contents

incentive income from those funds. The loss of either Mr. Novogratz or Mr. Levinson, could, therefore, ultimately result in a loss of a material portion of our earnings attributable to our liquid hedge fund business segment.

The loss of Mr. Briger or his inability 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 and us 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 our principals, and the resignation or termination of any such senior employee could result in a material adverse effect on the applicable fund or funds and on us. 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, our 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.**

Our success depends on our ability to retain our managing directors and the other members of our investment management team and to recruit additional qualified personnel. We refer to these key employees (other than our principals) collectively as 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 that 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 particular, some jurisdictions in which we operate our businesses have public policies limiting the enforcement of restrictive covenants applicable to employees. In addition, these agreements will expire after a certain period of time following

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

resignation or termination, at which point such persons 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

## Table of Contents

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. In recent years, various legislative and regulatory bodies (particularly in Europe) have focused on the issue of compensation in the financial services industry. Although new regulations flowing out of these bodies have only just begun to take effect and the specific impact on the Company is not yet clear, there is the potential that new compensation rules will make it more difficult for us to attract and retain talent by capping overall compensation levels, requiring the deferral of certain types of compensation over time, implementing clawback requirements, or other rules deemed onerous by potential employees.

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 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 for other liquidity needs. This retention risk is heightened during periods where market conditions make it more difficult to generate positive investment returns.

### **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, to a lesser extent, 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, disabled, or are the target of a cyber security attack 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

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

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 third parties to provide critical front- and back-office systems support to Logan Circle Partners. Any interruption or deterioration in the performance of these third parties, particularly with respect to the services provided to Logan Circle Partners, could impair the quality of operations and could impact our reputation and adversely affect our business and limit our ability to grow.

Table of Contents

**Our removal as the investment manager, or the liquidation, of one or more of our funds could have a material adverse 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 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 any investment management agreement for such funds is 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.

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 credit agreement. 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 or Castles, which could have a material adverse effect on our results of operations.

Under the terms of our credit agreement, if, subject to certain exceptions, we cease to serve as the investment manager of any fund that generated 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 fund that has generated at least 10% of all management fees generated during the previous four fiscal quarters 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 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 may become involved in lawsuits or investigations that could result in significant liabilities and reputational harm, which could materially adversely affect our results of operations, financial condition and liquidity.**

We could be sued by many different parties, including our fund investors, creditors of our funds, shareholders of the companies in which our funds have investments, our own shareholders, our employees, and regulators, among others. 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 increased risk from countersuits. Any of these parties could bring an array of claims not just against us but also against our funds and their portfolio companies or other investments based on a variety of allegations, including conflicts of interest, improper related party transactions, breaches of financing or other agreements, non-compliance with organizational documents, misconduct by employees and improper influence over the companies in which our funds or accounts have investments. It is likely that we would be brought into any lawsuit that involves a fund-related issue.

Lawsuits or investigations in which we may become involved could be very expensive and highly damaging to our reputation, even if the underlying claims are without merit. We could potentially be found liable for significant damages. For instance, in a lawsuit based on an allegation of negligent management of any of our funds, plaintiffs could potentially recover damages in an amount equal to the fund's investment losses. In general, the applicable standard of care in our contracts with fund or account investors is gross negligence or willful misconduct. However, the majority of the capital in

Table of Contents

our Logan Circle Partners business is managed under a negligence or reasonable person standard of care, which is more favorable to plaintiffs.

Although we have certain indemnification rights from the funds we manage, these rights may be challenged. Moreover, we could incur legal, settlement and other costs in an amount that exceeds the insurance coverage maintained by us or by our funds. The costs arising out of litigation or investigations could have a material adverse effect on our results of operations, financial condition and liquidity.

Certain of our consolidated subsidiaries have potentially unlimited liability for the obligations of various Fortress Funds under applicable partnership law principles, because they act as general partners of such funds. In the event that any such fund were 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 our balance sheet in consolidation until the time such liability were legally resolved.

We also face the risk of lawsuits relating to claims for compensation, which may individually or in the aggregate be significant in amount, particularly since our workforce consists of many very highly paid investment professionals. Such claims are more likely to occur when individual employees experience significant volatility in their year-to-year compensation due to trading performance or other issues, and in situations where previously highly compensated employees are terminated for performance or efficiency reasons, as has occurred recently. The cost of settling such claims could adversely affect our results of operations.

As part of the Dodd-Frank Act, new so-called whistleblower provisions have been enacted that will entitle persons who report alleged wrongdoing to the SEC to cash rewards. We anticipate that these provisions will result in a significant increase in whistleblower claims across our industry, and dealing with such claims could generate significant expenses and take up significant management time, even for frivolous and non-meritorious claims. 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 expense 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.

**We do not know whether the U.S. government's various efforts to attempt to strengthen the economy and the financial markets or its increased focus on the regulation of the financial services industry will adversely affect our business.**

In recent years, the U.S. government has taken a number of steps to attempt to strengthen 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. There can be no assurance that these steps will have a lasting beneficial impact on the financial markets. To the extent that the markets do not respond favorably to such actions or such actions do not function as intended, there may be broad adverse market implications, which could have a material adverse affect on our business.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted in July 2010, may adversely affect our business. The Act imposes significant new rules on almost every aspect of the U.S. financial services industry, including aspects of our business and the markets in which we operate. These rules address, among other things, the following topics:

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

- oversight and regulation of systemic market risk (including the power to liquidate certain institutions);
- regulation by the Federal Reserve of non-bank institutions;
- prohibitions on insured depository institutions and their affiliates from conducting proprietary trading and investing in private equity funds and hedge funds;
- new registration, recordkeeping and reporting on private fund investment advisers;
- exchange-trading of OTC derivatives;
- minimum equity retention requirements for issuers of asset-backed securities;
- the establishment of a new bureau of consumer financial protection;
- new requirements and higher liability standards on credit rating agencies;
- increased disclosure of executive compensation and mandatory shareholder votes on executive compensation.

Since many key rules will be implemented by various regulatory bodies and other groups over the next several years, we do not know exactly what the final regulations under the Act will require or how significantly the Act will affect us. For instance, in January 2010, the SEC proposed a rule that would require fund advisors with over \$1 billion in AUM, such as Fortress, to file substantial quarterly disclosure on fund assets, leverage, investment positions, valuations, trading practices and other topics. It is likely that the Dodd-Frank Act will, among other things, increase our costs of operating as a public

### Table of Contents

company and impose restrictions on our business. For example, the Act could increase our overall costs of entering into derivatives transactions and could also adversely affect the performance of certain of our trading strategies. The Act will impose mandatory clearing, exchange-trading and margin requirements on many derivatives transactions (including formerly unregulated over-the-counter derivatives) in which we engage. The Act also creates new categories of regulated market participants, such as swap-dealers, security-based swap dealers, major swap participants and major security-based swap participants who will be subject to significant new capital, registration, recordkeeping, reporting, disclosure, business conduct and other regulatory requirements that will give rise to new administrative costs. Even if certain new requirements are not directly applicable to us, they may still increase our costs of entering into transactions with the parties to whom the requirements are directly applicable. Moreover, new exchange-trading and trade reporting requirements may lead to reductions in the liquidity of derivative transactions, causing higher pricing or reduced availability of derivatives, or the reduction of arbitrage opportunities for us, which could adversely affect the performance of certain of our trading strategies.

### **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 the 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 regulatory oversight. For example, Springleaf Finance Inc. (formerly American General Finance Inc.), in which one of our funds acquired a majority stake in 2010, is in the consumer finance industry, which has recently been the focus of extensive regulation. Moreover, some of the portfolio companies in our funds are subject to regulation from non-financial bodies (such as our senior living and railroad investments). As an affiliate of a registered broker-dealer, we are subject to certain rules promulgated by the Financial Industry Regulatory Authority ( FINRA ) and the SEC. 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 in Singapore, Australia and other parts of the globe, are subject to a variety of regulatory regimes that vary 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.

Changes in ERISA requirements, or a failure to comply with ERISA requirements, could adversely effect our business. 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 that 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. Approximately one-third of the capital managed in our Logan Circle business is subject to ERISA requirements, and our failure to comply with those requirements could have a material adverse effect on our business.

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

### Table of Contents

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.

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 could harm our reputation, result in redemptions by our fund investors and impede our ability to raise additional capital or new funds.

### **New European Union legislation for fund managers could increase our costs and make it more difficult to operate and market our funds.**

European regulators have approved legislation (the Alternative Investment Fund Managers Directive, or AIFMD) requiring fund managers to comply with new rules regarding their activities in the EU, including the marketing of fund interests to EU-domiciled investors. The Directive additionally covers topics such as periodic reporting to fund investors, disclosures to shareholders of EU companies targeted for acquisition or disposition, limitations on dividends by fund-controlled EU companies, and monitoring the use of leverage. The final details of AIFMD were agreed in May 2011. However, implementing legislation at an EU and national level has not yet been issued and is unlikely to be made available for review before early 2012. It is anticipated that the applicable new laws will come into force by July 2013, but until the details of the implementing legislation are finalized we will not know what the impact will be on our business. However, such laws could impose significant additional costs on the operation of our business in the EU, limit our operating flexibility, restrict the size of EU-based funds and generally hamper our ability to grow our business in Europe.

### **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 that 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, from time to time, made advances or loans to, or acquired preferred equity interests in, various of our investment funds or other investment vehicles. 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 personal investments by our principals 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 held by disinterested parties that may be cast in the election of directors, (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

Table of Contents

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 could lead to redemptions by investors in our hedge funds, hamper our ability to raise additional funds and discourage counterparties to do business with us. Any such development could have a material adverse effect on our business.

**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 misconduct 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 alternative investment management business is intensely competitive.**

The recession of the past few years increased the level of competition for capital raising, particularly for big-fund capital in the alternative investment industry. When trying to raise new capital, we will therefore 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 new 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;
- our actual or perceived financial condition, liquidity and stability;
- the quality and mix of services provided to, and the duration of relationships with, investors;

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

- our business reputation; and
- the 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 dissatisfaction with our investment performance, 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;
- 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;

Table of Contents

- 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 top performers, 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 relevant facts 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 a less thorough diligence process than would otherwise be the case. 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.

**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, 2010, 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 has proposed changes to the rules for consolidating entities in financial statements, which, if enacted with respect to our funds, may 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 or document effective internal control over financial reporting, our independent registered public accounting firm would 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, or may cause us to restate previously issued financial information, 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 by, for example, leading to a decline in our share price and impairing our ability to raise capital.

**Our continued growth places significant demands on our administrative, operational and financial resources.**

Our continued growth creates significant demands on our legal, accounting and operational infrastructure, and results in 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 businesses. For example, in April 2010 we acquired Logan Circle Partners, which requires operational infrastructure that differs from the infrastructure used in our alternative asset management business, which we were not familiar with prior to the acquisition. In addition, we recently opened an office in Singapore, which subjects us to Asian regulatory and market risks, and we are generally focused on expanding our presence in Asia. 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 continued 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:

- maintaining adequate accounting, financial, compliance, trading and other business controls,
- implementing new or updated information, financial and disclosure systems and procedures, and
- recruiting, training, managing and appropriately sizing our work force and other components of our business on a timely and cost-effective basis.

**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, 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. 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, in April 2010 we 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 and which operates under a standard of care that is generally less favorable to us and exposes us to greater liability for simple negligence than do our alternative asset management businesses. 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

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

if, any realization of investments will occur. If we were 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 that 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.

Table of Contents

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. Each fund must generate earnings, on an investor by investor basis, equal to any amount lost as a result of negative performance before it will generate additional incentive income for us from existing fund investors. See the Management Agreements and Fortress Funds note 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 private equity style funds, as of September 30, 2011, 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. See the Management Agreements and Fortress Funds note to the consolidated financial statements included herein for more information.

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 credit agreement, we have a \$60 million revolving credit facility and a \$270 million term loan facility. As of September 30, 2011, we had a \$270 million term loan outstanding and nothing outstanding under our revolving credit facility (\$6.1 million of letters of credit were outstanding under a letter of credit subfacility). Borrowings under our revolving credit facility mature on October 7, 2013, and borrowings under our term loan facility mature on October 7, 2015. 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. We may, from time to time, hedge these interest rate related risks. There is no guarantee that any such hedges will be economically effective.

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

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

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. 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 those of a smaller 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 [Item 19](#)). 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

Table of Contents

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;
- the performance of a number of our funds that 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 historically from investment opportunities and general market conditions that currently may 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
- 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 a Fortress fund reduces its investment in them.

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

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

Poor performance of our funds could have a material adverse impact on our primary sources of revenue, which are: (1) management fees, which are based on the size of our funds; (2) incentive income, which is 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. Losses in our funds result in a decrease in the size of our funds, which results in lower management fee revenues. In addition, 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 they may require advances to cover expenses if they perform poorly or suffer from liquidity constraints due to operational or market forces.

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 September 30, 2011, the aggregate amount of management fees that various of our managed funds currently owe but have not yet paid was approximately \$107.2 million, of which \$12.0 million 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 \$34.0 million. We anticipate that deferred receivables from our PE funds may continue to increase in the near future.

In addition, as a result of poor performance of our funds or other factors, 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. Our liquid hedge funds received redemption requests, including from affiliates, for a total of \$1.3 billion during the period ended September 30, 2011 and \$1.2 billion and \$2.3 billion during the years ended December 31, 2010 and 2009, respectively, and our credit hedge funds received return of capital requests, including from affiliates, for \$0.6 billion during the period ended September 30, 2011 and for \$0.9 billion and \$1.4 billion during the years ended December 31, 2010 and 2009, respectively. In October 2011, the due date on which redemption requests may be made with respect to our flagship credit hedge fund passed, and we received \$0.2 billion of additional redemption requests with respect to this fund subsequent to quarter end.

Table of Contents

If, as a result of poor performance of investments in a private equity fund or credit PE fund, the fund does not achieve total investment returns that exceed a specified investment return threshold for 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 September 30, 2011, the cumulative clawback obligation to investors in these funds would be approximately \$66.0 million (net of amounts that would be due from employees pursuant to profit sharing arrangements, and without regard to potential tax adjustments).

We may be unable as a result of poor fund performance 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 our results of operations.**

Our funds are materially affected by conditions in the global financial markets and economic conditions throughout the world. The global market and economic climate may be adversely affected by factors beyond our control, including rising interest rates or accelerating asset deflation or inflation, 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. 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, media and gaming) 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.

The recent financial downturn adversely affected our operating performance in a number of ways, and if the economy were to re-enter a period of recession, it may cause our revenue, results of operations and financial condition to decline by causing:

- AUM to decrease, lowering management fees;
- increases in costs associated with 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 would reduce our ability to realize incentive income from these investments;

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

- 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 mortgage opportunities 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.

Table of Contents

**Our funds may make investments that are concentrated in certain companies, asset types or geographical regions, which means that negative developments in certain sectors could have a material adverse effect on our revenues and results of operations.**

The governing agreements of our funds contain only limited investment restrictions and only limited requirements as to diversification of fund investments, whether by geographic region or asset type. Many of our private equity funds have significant investments in particular companies whose assets are concentrated in the following industries, among others: transportation, financial services (particularly loan servicing), leisure and gaming, real estate (including Florida commercial real estate and German residential real estate) and senior living facilities. If these sectors, or any other sector in which our funds have concentrated investments, were adversely affected by market conditions or other factors, certain of our funds may perform poorly. For example, if the commercial real estate operating environment in Florida remains challenging or deteriorates further, our fund investments in Flagler Development Group could decline in value and potentially have a material adverse effect on overall fund performance. Moreover, poor performance by our private equity business could harm our reputation, which could make it difficult for us to raise capital for our other businesses. For a description of the consequences to us of poor fund performance, see Poor performance of our funds would cause a decline in our revenue and results of operations, could obligate us to repay incentive income previously paid to us, and could adversely affect our ability to raise capital for future funds.

**Our Castles and funds could be adversely affected by a contraction of the structured finance and mortgage markets.**

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 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.

Many of our funds also have relied on the structured finance markets. To the extent that financing of that type is unavailable or limited, such 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 from their investments and could lead to a reduction in overall investments by those funds and a slower rate of growth of fee paying assets under management in those funds, with 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.

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

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, 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.

Table of Contents

The counterparty risks that we face have increased in complexity and magnitude as a result of the recent insolvency of a number of major financial institutions (such as Lehman Brothers and AIG) who served 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 tightened their underwriting standards and increased their margin requirements for 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 only limited 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 if aggregate counterparty risk were to be 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.**

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, and our flagship liquid markets hedge fund has a monthly redemption class. 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, dissatisfaction 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 were 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 \$1.3 billion during the period ended September 30, 2011 and \$1.2 billion and \$2.3 billion during the years ended December 31, 2010 and 2009, respectively. Investors in our credit hedge funds are permitted to request that their capital be returned generally 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 from affiliates, for those credit hedge funds were \$0.6 billion for the period ended September 30, 2011 and \$0.9 billion and \$1.4 billion for the years ended December 31, 2010 and 2009, respectively. In October 2011, the due date on which redemption requests may be made with respect to our flagship credit hedge fund passed, and we received \$0.2 billion of additional redemption requests with respect to this fund subsequent to quarter end.

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

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

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.

Table of Contents

**A decline in AUM could result in one or more defaults under our fund agreements, which could negatively impact our business.**

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.

**Many of our funds invest in 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.**

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

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

Table of Contents

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 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 that are unstable, in distress, or in the midst of 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.**

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

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 complete 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 they are subject to significant uncertainty in general if they are not widely traded securities or 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

Table of Contents

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 our operating results.

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.

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 involves 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, which may entail risks that are not typically associated with an investment in a U.S. issuer. In addition to business uncertainties, such investments may be affected by changes in exchange values. Recently, the instability of the euro zone, including fears of sovereign debt defaults, and stagnant growth of certain euro zone member states have resulted in concerns regarding the suitability of a shared currency for the region, which could lead to the reintroduction of individual currencies for member states. If this were to occur, euro-issued assets and liabilities of certain of our funds would be redenominated to such individual currencies, which could result in a mismatch in the values of assets and liabilities and expose us and certain of our funds to additional currency risks. Even if the euro is maintained, continued concerns regarding the stability of the euro zone and the potential effects of government intervention intended to address it could materially adversely affect our business.

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

Foreign investments may also expose us to political, social and economic uncertainties affecting a country or region, or to political hostility to investments by foreign or private equity investors. Many financial markets are not as developed or as efficient as those in the United States, 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. For example, one of our funds' portfolio companies, in which we have a direct investment, a German residential housing company called GAGFAH, is facing an arbitration claim from the city of Dresden for a material amount of damages based on the city's interpretation of the acquisition agreement under which GAGFAH purchased certain properties from the city, and a materially adverse decision in that case could have a material adverse effect on the several Fortress funds that have an

Table of Contents

investment in GAGFAH. Restrictions imposed or actions taken by foreign governments could also 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 even the capital invested. 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 we 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 fund's investment. Also, in the event of insolvency, liquidation, 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 intellectual property rights through litigation, or a strategy of purchasing pools of tax liens on residential buildings or pools of life settlements—may negatively impact one or more other Fortress funds whether due to reputational or other concerns. We have recently been subjected to intermittent protests by groups affiliated with an animal rights movement related to a historical investment. Although no Fortress Fund continues to hold the investment targeted by such protestors, the protest activity may nevertheless have a negative effect on our reputation.
- 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

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

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 depends 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

Table of Contents

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 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. The Dodd-Frank Act will also give rise to a substantial set of new rules focused on the use of derivatives, which when fully formulated and enacted may lead to requirements to post additional capital or which may otherwise make our use of derivatives less efficient.
- Fund investments may also be subject to litigation, which could impact the value of the investment and harm the performance of one or more of our funds.

**We have been engaged as the investment manager of third-party investment funds and managed accounts, and we may be engaged as the investment manager of other 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 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 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 engagement. 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 liabilities 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 various lawsuits relating to the Zwirn portfolio, and as part of our role as manager, we may incur time and expense in defending these 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's 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

Table of Contents

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 amounts 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 made investment decisions based on the information that was available then, 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.

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;
- ten percent share issuance: any issuance by us, in any transaction or series of related transactions, of equity or equity-related securities that 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 more: 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 equal to or 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

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

- the termination without cause of the employment of a principal with us or any of our material subsidiaries.

Furthermore, the principals have certain consent rights with respect to structural changes involving our company.

Because our principals primarily hold their economic interest in our business directly through Fortress Operating Group, rather than through the public company, they 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, or to make payments to our principals under the tax receivable agreement will result in a corresponding pro rata distribution to our principals. Our principals are also entitled to distributions on their Fortress Operating Group units in respect of their tax obligations as holders of FOG units. As a result of the foregoing, amounts may be distributed to the holders of the FOG units that are greater in the aggregate, or are distributed earlier in time, than distributions that are made to holders of Class A shares (on a per share basis).

Table of Contents

**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 current quarter. Our board has announced its intention to resume quarterly dividends, beginning with the fourth quarter of 2011. 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 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 that 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.

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 credit agreement, our ability to pay dividends is restricted by the amortization requirements and the requirement that beginning in 2010, under certain circumstances, we use 50% of our free cash flow (as defined in the agreement) to make amortization payments. Under our 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 that are due 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.**

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

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, or as a result of other differences between the tax attributes of our principals and the Fortress Operating Group entities, upon the sale, 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

Table of Contents

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 of our principals and one senior employee (who is not a 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. 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.

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 we are not an investment company under Section 3(b)(1) of the Investment Company Act because we are 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

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

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 may be highly volatile. 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.

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

### Table of Contents

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 reversal of our decision to resume quarterly dividends (beginning with the fourth quarter of 2011);
- 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 or lack of certainty about the principals' employment agreements, whose term ends in January 2017;
- 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.

**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 September 30, 2011, we had 494,994,029 outstanding Class A shares on a fully diluted basis, including 31,921,678 resulting from vested equity compensation granted pursuant to our equity incentive plan, 35,779,775 restricted Class A share units granted to employees and affiliates pursuant to our equity incentive plan (net of forfeitures), 570,293 restricted Class A shares granted to directors pursuant to our equity incentive plan, and 64,758,208 Class A shares and Fortress Operating Group units that remain available for future grant under our equity incentive plan. Approximately 10.0 million and 11.4 million restricted Class A share units granted to Fortress employees and affiliates vested on January 1, 2011 and 2010, respectively, and became eligible for resale by the holders, with a similar amount vesting on each of the two 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 2011 and 2010, respectively, the number of shares reserved for issuance pursuant to this calculation increased by 13,161,401 and 4,868,553 shares, respectively. 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 to a senior employee 31,000,000 Fortress Operating Group restricted partnership units ( RPU's ) that vest into full capital interests in Fortress Operating Group units, subject to the recipient's continued employment with Fortress. On January 1, 2011, 10,333,333 of these RPUs vested, and the remaining unvested RPUs are scheduled to vest in equal increments in January 2012 and January 2013. If and when vested, these Fortress Operating Group units will be exchangeable into Class A shares on a one-for-one basis. In addition, such units have the same resale terms and restrictions as those applicable to the principals' Fortress Operating Group units.

Table of Contents

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 and the Exchange 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.

**Concentrated ownership of our Class B shares and anti-takeover provisions in our charter documents and Delaware law could delay or prevent a change in control.**

Our principals and one senior employee (who is not a principal) beneficially own all of our Class B shares. 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 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 as 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.**

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

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 requirements that:

- a majority of our board of directors consist of independent directors;
- we have a nominating/corporate governance committee that is composed entirely of independent directors; and
- 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.

Table of Contents

*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 subsidiary, 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 our subsidiary FIG Asset Co. LLC, (but excluding through its taxable corporate affiliates) is not subject to corporate income 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.

**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;

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

- 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 Class A shares could be more or less than expected.**

Upon a sale of Class A shares the shareholder will recognize a gain or loss equal to the difference between the amount realized and the adjusted tax basis in those shares. Prior distributions to such shareholder in excess of the total net taxable income allocated to such shareholder, which decreased the tax basis in its Class A shares, will increase the gain recognized upon a sale when the Class A shares are sold at a price greater than such shareholder's tax basis in those shares, 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.

Table of Contents

**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 our Class A shares could be allocated more taxable income in respect of those shares 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 subsequent transferee's acquisition of Class A shares from a prior holder of such shares, even if the purchase price for those shares is greater than the portion of the aggregate tax basis of our assets attributable to those shares immediately prior to the acquisition. Consequently, upon our sale of an asset, gain allocable to a holder of Class A shares could include built-in gain in the asset existing at the time such holder acquired such shares, 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.

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 the 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.**

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

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.

Table of Contents

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 our 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 our Class A shares, 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 Class A shares.**

Because we cannot match transferors and transferees of our Class A shares, 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 our Class A shares and could have a negative impact on the value of our Class A shares or result in audits of and adjustments to our shareholders' 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 shareholders and could result in a deferral of depreciation deductions allowable in computing our taxable income.

**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 that we may not have otherwise entered into.**

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

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 would be 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.**

Table of Contents

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 would be 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.

**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 May 2010, the U.S. House of Representatives passed H.R. 4213, the American Jobs and Closing Tax Loopholes Act of 2010. That proposed legislation contains a provision that, if enacted, would have the effect of treating some or all of the 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, or converting to a corporation, 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.

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

Other legislative proposals previously considered would 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.

In addition, as a result of widespread budget deficits, several states are evaluating proposals to subject partnerships to 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.

Table of Contents

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

None.

**Item 3. Defaults upon Senior Securities**

None.

**Item 4. (Removed and 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).

4.1 Specimen Certificate evidencing the Registrant's Class A shares (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 4.1).

4.2 Form of Shareholders Agreement, by and among the Registrant, Peter Briger, Wesley Edens, Randal Nardone, Robert Kauffman, and Michael Novogratz (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 4.2).

4.3 Investor Shareholder Agreement, dated January 17, 2007, by and between the Registrant and Nomura Investment Managers U.S.A., Inc. (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 4.3).

10.1 Form of Agreement Among Principals, by and among Peter Briger, Wesley Edens, Randal Nardone, Robert Kauffman, and Michael Novogratz (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 10.1).

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

10.2 Amended and Restated Tax Receivable Agreement dated February 1, 2007, by and among FIG Corp., FIG Asset Co. LLC, the entities set forth on the signature pages thereto and each of the parties thereto identified as partners (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 10.3).

10.3 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 Registration Statement on Form S-1 (File No. 333-138514), Exhibit 10.12).

10.4 Certificate of Incorporation of FIG Corp. (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 10.13).

10.5 By-Laws of FIG Corp. (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 10.14).

10.6 Certificate of Formation of FIG Asset Co. LLC (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 10.15).

10.7 Operating Agreement of FIG Asset Co. LLC (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 10.16).

10.8 Amended and Restated Limited Partnership Agreement of Fortress Operating Entity I LP (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 10.17).

10.9 Amended and Restated Limited Partnership Agreement of Principal Holdings I LP (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 10.20).

10.10 Amended and Restated Exchange Agreement among FIG Corp., FIG Asset Co. LLC, Peter Briger, Wesley Edens, Randal Nardone, Robert Kauffman, Michael Novogratz, Adam Levinson, Fortress Operating Entity I LP, and Principal Holdings I LP (incorporated by reference to the Registrant's Annual Report on Form 10-K filed with the SEC on March 1, 2011 (File No. 001-33294), Exhibit 10.17).

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

### Table of Contents

- 10.11 Employment Agreement by and between Daniel Bass and the Registrant (incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-138514), Exhibit 10.24).
- 10.12 Employment Agreement by and between David Brooks and the Registrant (incorporated by reference to the Registrant's Annual Report on Form 10-K filed with the SEC on March 28, 2008 (File No. 001-33294), Exhibit 10.25).
- 10.13 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).
- 10.14 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).
- 10.15 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).
- 10.16 Credit Agreement, dated as of October 7, 2010, among FIG LLC, a Delaware limited liability company, as borrower, certain subsidiaries and affiliates of the borrower, as guarantors, Wells Fargo Bank, National Association, individually and as administrative agent and letter of credit issuer, Bank of America, N.A., individually and as syndication agent, Citigroup Global Markets Inc. and Barclays Bank PLC, as co-documentation agents, and the lenders party thereto (incorporated by reference to the Registrant's Current Report on Form 8-K filed with the SEC on October 7, 2010 (File No. 001-33294), Exhibit 10.1).
- 10.17 Principal Compensation Plan, effective as of January 1, 2012 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011 filed with the SEC on August 4, 2011).
- 10.18 Employment, Non-Competition and Non-Solicitation Agreement of Peter L. Briger, Jr., dated August 4, 2011 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011 filed with the SEC on August 4, 2011).
- 10.19 Employment, Non-Competition and Non-Solicitation Agreement of Wesley R. Edens, dated August 4, 2011 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011 filed with the SEC on August 4, 2011).

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

10.20 Employment, Non-Competition and Non-Solicitation Agreement of Robert I. Kauffman, dated August 4, 2011 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011 filed with the SEC on August 4, 2011).

10.21 Employment, Non-Competition and Non-Solicitation Agreement of Randal A. Nardone, dated August 4, 2011 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011 filed with the SEC on August 4, 2011).

10.22 Employment, Non-Competition and Non-Solicitation Agreement of Michael E. Novogratz, dated August 4, 2011 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011 filed with the SEC on August 4, 2011).

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.

101.INS\*\* XBRL Instance Document.

101.SCH\*\* XBRL Taxonomy Extension Schema Document.

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

Table of Contents

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

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

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

---

\*\*XBRL (Extensible Business Reporting Language) information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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

November 3, 2011

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

November 3, 2011

By: /s/ John A. Konawalik  
John A. Konawalik  
Principal Accounting Officer

November 3, 2011