SANGSTAT MEDICAL CORP
Form SC 14D9
August 13, 2003

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14D-9
SOLICITATION/RECOMMENDATION STATEMENT

UNDER
SECTION 14(d)(4) OF THE SECURITIES EXCHANGE ACT OF 1934

SANGSTAT MEDICAL CORPORATION

(Name of Subject Company)

SANGSTAT MEDICAL CORPORATION

(Name of Person Filing Statement)

COMMON STOCK, PAR VALUE $.001 PER SHARE
(INCLUDING THE ASSOCIATED PREFERRED STOCK PURCHASE RIGHTS)

(Title of Class of Securities)

801003104

(CUSIP Number of Class of Securities)

Richard D. Murdock
Chairman, President and Chief Executive Officer
SangStat Medical Corporation
6300 Dumbarton Circle
Fremont, California 94555
(510) 789-4300

(Name, Address and Telephone Number of Person Authorized to
Receive Notice and Communications on Behalf of the Person Filing Statement)

WITH COPIES TO EACH OF:

Adrian Arima, Esq.
Senior Vice President, General Counsel
and Secretary
SangStat Medical Corporation
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Check the box if the filing relates solely to preliminary communications made before the commencement of a tender offer.

Item 1. Subject Company Information.

The name of the subject company is SangStat Medical Corporation, a Delaware corporation (the "*Company*" or "*SangStat*"). The address of the principal executive offices of SangStat is 6300 Dumbarton Circle, Fremont, California 94555. The telephone number of SangStat at its principal executive offices is (510) 789-4300.

The title of the class of equity securities to which this Solicitation/Recommendation Statement on Schedule 14D-9 (together with the Exhibits and Annexes hereto, this "*Statement*") relates is the common stock, par value $.001 per share, of SangStat (the "*Common Stock*"), including the associated preferred stock purchase rights (the "*Company Rights*") issued pursuant to the Rights Agreement, dated as of August 14, 1995, between SangStat and Equiserve Trust Company N.A., as rights agent, as amended from time to time. As of June 30, 2003, there were 26,469,087 shares of Common Stock outstanding.

Item 2. Identity and Background of Filing Person.

The filing person is the subject company. SangStat's name, business address and business telephone number are set forth in Item 1 above.

This Statement relates to the offer by Swift Starboard Corporation (the "*Purchaser*"), a Delaware corporation and a wholly owned subsidiary of Genzyme Corporation, a Massachusetts corporation ("*Genzyme*"), to purchase each issued and outstanding share of Common Stock, including the Company Rights (each, a "*Share*"), for $22.50 net to the seller in cash, without interest (such price per share, or the highest price paid in the offer, the "*Offer Price*") upon the terms and subject to the conditions set forth in the Offer to Purchase, dated August 13, 2003 (as amended or supplemented from time to time, the "*Offer to Purchase*"), and in the related Letter of Transmittal (which, together with the Offer to Purchase, as may be amended or supplemented from time to time, constitute the "*Offer*"). The Offer is further described in a Tender Offer Statement on Schedule TO (as amended or supplemented from time to time, the "*Schedule TO*") filed by Genzyme and the Purchaser with the Securities and Exchange Commission on August 13, 2003. A copy of each of the Offer to Purchase and the Letter of Transmittal are attached as Exhibit (a)(1) and Exhibit (a)(2), respectively, to the Schedule TO, and each is incorporated herein by reference.

The Offer is being made pursuant to the Agreement and Plan of Merger, dated as of August 4, 2003, among Genzyme, SangStat and the Purchaser (the "*Merger Agreement*"). The Merger Agreement provides that, subject to the satisfaction or waiver of certain conditions, and in accordance with the Delaware General Corporation Law (the "*DGCL*"), the Purchaser will be merged with and into SangStat with SangStat surviving the Merger (such surviving corporation is sometimes referred to as the "*Surviving Corporation*" and such merger is referred to as the "*Merger*"). At the effective time of the Merger (the "*Effective Time*"), each issued and outstanding share of the common stock, par value $0.001 per share, of the Purchaser shall be converted into one fully paid and nonassessable share of common stock of the Surviving Corporation, all Shares that are owned by SangStat as treasury stock and any Shares owned by Genzyme or the Purchaser shall be cancelled and retired and shall cease to exist and all other issued and outstanding Shares (other than Dissenting Shares) shall be converted into the right to receive the Offer Price, without interest (the "*Merger Consideration*"). Shares held by stockholders who have not voted in favor of the Merger or consented thereto in writing and who have properly demanded appraisal and complied with the provisions of Section 262 of the DGCL relating to dissenters' rights of appraisal (the "*Dissenting Shares*") shall not be converted into a right to receive the Merger Consideration, unless such holder fails to perfect, withdraws or otherwise loses his, her or its right to appraisal.

As set forth in the Schedule TO, the principal executive offices of Genzyme and the Purchaser are located at One Kendall Square, Cambridge, Massachusetts 02139.

Item 3. Past Contacts, Transactions, Negotiations and Agreements.

Certain contracts, agreements, arrangements or understandings between SangStat or its affiliates and certain of its directors and executive officers are, except as noted below, described in the Information Statement (the "*Information Statement*") pursuant to Rule 14f-1 under the

Securities Exchange Act of 1934 that is attached as Annex B to this Statement and is incorporated herein by reference. Except as described in this Statement (including in the Exhibits hereto and in Annex B hereto) or incorporated herein by reference, to the knowledge of SangStat, as of the date of this Statement, there exists no material agreement, arrangement or understanding or any actual or potential conflict of interest between SangStat or its affiliates and (1) SangStat's executive officers, directors or affiliates or (2) the Purchaser, Genzyme or their respective executive officers, directors or affiliates.

The Merger Agreement. The summary of the Merger Agreement and the description of the conditions to the Offer contained in the Introduction and Sections 12 and 14 of the Offer to Purchase, which is being mailed to stockholders together with this Statement, are incorporated herein by reference. Such summary and description are qualified in their entirety by reference to the Merger Agreement, which has been filed as Exhibit (e)(1) hereto and is incorporated herein by reference.

Confidentiality Agreement. The summary of the Confidentiality Agreement contained in Section 12 of the Offer to Purchase is incorporated herein by reference. Such summary is qualified in its entirety by reference to the Confidentiality Agreement, which has been filed as Exhibit (e)(3) hereto and is incorporated herein by reference.

Effects of the Offer and the Merger under Company Stock Plans and Agreements Between SangStat and its Executive Officers.

Interests of Certain Persons. Certain members of SangStat's management and SangStat's Board of Directors (the "*Board*") may be deemed to have interests in the transactions contemplated by the Merger Agreement that are different from or in addition to their interests as Company stockholders generally. The Board was aware of these interests and considered them, among other matters, in approving the Merger Agreement and the transactions contemplated thereby. As described below, consummation of the Offer will constitute a change in control of SangStat for the purposes of determining the entitlements due to the executive officers and directors of SangStat to certain severance and other benefits.

Stock Options. All options under SangStat's option plans, whether or not vested, will become fully vested and exercisable immediately prior to the consummation of the Merger and be cancelled. Promptly following the consummation of the Merger, Genzyme or the Surviving Corporation shall pay each option holder cash in an amount equal to the product of (a) the amount, if any, by which $22.50 (or the highest price paid for any Share in the Offer) exceeds the per Share exercise price of such option holder's options and (b) the number of shares underlying such option holder's options. The foregoing summary is qualified in its entirety by reference to the Merger Agreement, which has been filed as Exhibit (e)(1) hereto and is incorporated herein by reference.

Change of Control Agreements. Change of control agreements that contain severance provisions are in effect between SangStat and Steve Aselage, Ralph Levy, Joseph Lobacki, Marlene Perry, Raji Pichai, Rayasam Prasad, Adrian Arima, Brian Lundstrom, Steve Dance, Raymond Tesi and Timothy Fong. In the event that any of the above executives is terminated without cause or suffers an involuntary termination within one month prior to or within eighteen months following a change of control, including the Offer or the Merger, the executive will be entitled to receive a certain severance payment, which, depending on the individual, ranges from six months to two years base salary plus an amount equal to bonuses received in the previous twelve months and a pro-rated estimated bonus for the current year. The executive will also receive a certain period of Company-paid COBRA continuation benefits as well as outplacement services and the forgiveness of any sign-on bonus or

relocation advance, if applicable. In addition, upon a termination of employment entitling the individual to severance in connection with a change of control, any unvested stock options held by the executive will immediately accelerate and become exercisable. Under the terms of their agreements, Messrs. Dance and Aselage are entitled to two year's salary and COBRA continuation benefits, Messrs. Lundstrom, Levy, Tesi, Prasad and Arima and Ms. Perry are entitled to one year's salary and COBRA continuation benefits and Messrs. Lobacki and Fong and Ms. Pichai are entitled to six month's salary and COBRA continuation benefits. All benefits payable under the change of control agreements for Messrs. Aselage, Levy and Tesi and Ms. Perry would be reduced to the extent necessary to preserve the ability of SangStat to deduct the severance benefits paid and to prevent payments to any officer from exceeding the limit of Section 4999 of the Internal Revenue Code (the "Code"), applicable to any "excess parachute payment" (as defined in Section 280G of the Code). For Mr. Dance, the amount of such payments shall be either: (a) the full amount of the payments, or (b) a reduced amount which would result in no portion of the payments being subject to the excise tax imposed pursuant to Section 4999 of the Code, whichever of (a) or (b), taking into account the applicable federal, state and local income taxes and the excise tax, results in the receipt by the employee, on an after-tax basis, of the greatest amount of benefit.

Letter Agreements. SangStat is also party to a letter agreement with its current Chief Executive Officer, Richard Murdock, whereby if Mr. Murdock's employment is terminated without cause (as determined by the Board) within one month prior to or within eighteen months following a defined change of control, Mr. Murdock will be entitled to a severance payment of two year's base salary plus an amount equal to bonuses received in the previous twelve months, and one-half of any unvested stock options will become vested.

SangStat is also party to a letter agreement with its former Chief Executive Officer, Jean-Jacques Bienaimé, whereby certain of his unvested stock options will vest upon a defined change of control.

Employees. The Merger Agreement provides that employees of SangStat will be covered under Genzyme's then-current benefits plans, programs, policies and arrangements applicable to similarly-situated employees of Genzyme. Each employee's tenure with SangStat will be treated as service with Genzyme for eligibility and vesting purposes and for purposes of vacation and severance pay accruals, unless such treatment would result in a duplication of benefits. Such summary is qualified in its entirety by reference to the Merger Agreement, which has been filed as Exhibit (e)(1) hereto and is incorporated herein by reference.

Indemnification; Directors' and Officers' Insurance. The Merger Agreement provides that Genzyme shall, or shall cause the Surviving Corporation and its subsidiaries to, indemnify the present and former directors and officers of SangStat to the same extent and in the same manner as is now provided in the respective Certificates of Incorporation or the Bylaws of SangStat and such subsidiaries and any indemnity agreement in effect as of August 4, 2003 against any liabilities or expenses incurred in connection with any claim, liability, loss, damage, cost or expense (whether asserted or claimed) based in whole or in part on, or arising in whole or in part out of, any matter existing or occurring at or prior to the consummation of the Merger. The Merger Agreement further provides that, prior to the consummation of the Merger, SangStat may obtain an insurance policy for a period of six years following the consummation of the Merger, providing for officers and directors liability insurance substantially similar to coverage provided under SangStat's officer and director insurance policy for events occurring on or prior to the consummation of the Merger on terms substantially no less advantageous than SangStat's policy in effect on August 4, 2003; provided, however, that SangStat may not pay more than $3,500,000 to procure such insurance without Genzyme's prior written consent; provided further, that SangStat shall afford Genzyme the opportunity to purchase a substitute policy on terms not materially less favorable to SangStat.

Item 4. The Solicitation or Recommendation.

Recommendation of the Board.

The Board, at a meeting held on August 3, 2003, by a unanimous vote, approved the Merger Agreement and the transactions contemplated by the Merger Agreement including the Offer and the Merger, determined that the terms of the Offer and the Merger are fair to, and in the best interests of, SangStat and its stockholders, recommended that the stockholders of SangStat accept the Offer and tender their Shares to the Purchaser pursuant to the Offer, determined that the Merger Agreement is advisable and recommended that the stockholders of SangStat approve the Merger Agreement, to the extent such approval is required by applicable law.

(i) *Background of the Offer; Contacts with Genzyme*

The Board actively considered retaining the independent status of the company, primarily through potential partnering arrangement with RDP58, and, alternatively, the sale of the entire company, which resulted in an auction process conducted through Merrill Lynch & Co. ("*Merrill Lynch*") and, ultimately, the execution of the Merger Agreement with Genzyme.

Partnering Opportunities RDP58

Following SangStat's announcement of the successful clinical trial results of RDP58 in ulcerative colitis on April 9, 2003, SangStat increased its efforts to market a RDP58 collaboration with potential partners. These partnering activities were independent of but concurrent with the process described below which led to an agreement to sell SangStat to Genzyme. Interest in a RDP58 collaboration was assessed based upon numerous meetings with potential partners, resulting in a draft proposal by SangStat that was provided to the five potential partners who expressed the most interest and were perceived as having the desire and capability to rapidly close a major collaboration for RDP58. SangStat's proposal included the following proposed terms: (i) a license for first and second generation RDP molecules in the gastro-intestinal field and up to two non-gastro-intestinal formulations; (ii) a co-promotion right to SangStat of up to 40% of the commercial costs and profits in the U.S.; (iii) all subsequent development costs to be borne by the partner; (iv) milestone payments of up to $140 million for each licensed molecule; (v) a 15% royalty of net sales outside the area where SangStat co-promotes; and (vi) an equity investment of 3-4 million shares of SangStat common stock at a 50% premium.

Prior to the announcement of the proposed acquisition by Genzyme on August 4, 2003, SangStat received written proposals or expressions of interest from three potential partners with a fourth indicating a desire to continue discussions. While, as expected, none of the collaboration proposals were as favorable to SangStat as the terms circulated by SangStat, management believed, based on the proposals received and management's experience, that SangStat would be in a position to execute a collaboration transaction on terms generally comparable to those proposed except that: (i) the partner might obtain rights to additional generations of molecules and indications for the product; (ii) SangStat might be required to fund a portion of the clinical development costs; (iii) milestones were likely to be reduced for RDP58, and substantially reduced for subsequent molecules; and (iv) the amount of the equity investment would be significantly less than that proposed by SangStat, consistent with common industry practice. Despite management's expectations, no assurance can be given as to the ability of SangStat or Genzyme to complete a partnering agreement in accordance with SangStat's expectations or at all.

While two of the potential partners also indicated an interest in purchasing SangStat in its entirety, neither elected to proceed with the auction process described below, and none of the potential partners indicated an interest in solely purchasing the assets related to RDP58. Because the RDP proposals were received pursuant to confidentiality agreements, SangStat is prohibited from providing further specificity on any of the proposals or the identity of the partners prior to the execution of a definitive agreement with that partner.

Sale-Auction Process

During the week of February 17, 2003, representatives of Genzyme and SangStat met to discuss informally the businesses of the two companies. On February 27, 2003, Genzyme sent a letter to SangStat stating Genzyme's interest in pursuing a business combination.

During the following days, discussions continued between Mr. James Geraghty, Senior Vice President of Genzyme, Mr. Jan van Heek, Executive Vice President of Genzyme and Mr. Richard Murdock, then-acting Chief Executive Officer of SangStat. Discussions terminated in March 2003 due to, among other things, the pending clinical trials with RDP58.

On June 3, 2003, SangStat received a letter from a party other than Genzyme that was interested in acquiring all of the outstanding stock of SangStat on specific proposed terms at a substantial premium to the then-current trading price. On June 5, 2003, Mr. Murdock, Chief Executive Officer and President of SangStat, convened a meeting of the Board to review the terms of the offer and to discuss SangStat's response and its alternatives. Thereafter, the Board retained the services of Merrill Lynch to advise SangStat. The Board determined not to sell SangStat at that time but instructed management, in general, to continue operating the business in the ordinary course and, in particular, to continue to pursue partnering arrangements for RDP58 or Thymoglobulin. The Board also instructed Merrill Lynch to investigate a possible sale transaction as well through an auction process.

Thereafter, Merrill Lynch contacted approximately 17 parties that Merrill Lynch and the Company believed would potentially be interested in pursuing a business combination with SangStat, including the party that contacted SangStat on June 3rd. As a result of Merrill Lynch's solicitation efforts, 11 parties responded favorably and began to conduct preliminary due diligence on SangStat.

During the solicitation process undertaken by Merrill Lynch, on June 6, 2003, Mr. Murdock contacted Mr. van Heek to inquire about Genzyme's potential interest in a transaction at that time, since Genzyme had previously expressed interest in pursuing a business combination. Representatives at Merrill Lynch subsequently contacted representatives at Credit Suisse First Boston LLC ("*Credit Suisse First Boston*"), Genzyme's financial advisor, to solicit interest in a potential business combination.

On June 12, 2003, SangStat and Genzyme entered into a confidentiality agreement regarding a potential business combination. Thereafter, Mr. Murdock and selected members of the management team of SangStat, as well as representatives from Merrill Lynch and Skadden, Arps, Slate, Meagher & Flom LLP ("*Skadden, Arps*"), SangStat's legal advisor, participated in a conference call with Mr. Geraghty and selected members of the management team of Genzyme, as well as representatives from Credit Suisse First Boston. SangStat senior management provided Genzyme with an overview of SangStat's operations, products and development programs. The parties also discussed potential benefits of a transaction and potential issues related to a transaction, as well as due diligence issues that required further analysis by Genzyme.

While the following discussion focuses primarily on the interaction between SangStat and Genzyme, similar discussions and due diligence efforts ensued with parties that remained in the process through the submission of updated bids on July 24, 2003. Thereafter, similar discussions continued with the remaining bidders until July 30, 2003, when efforts were focused on the Genzyme proposal through announcement on August 4, 2003.

From June 13, 2003 through June 27, 2003, SangStat received indications of interest from five additional parties, including Genzyme. On June 16, 2003, Genzyme delivered a letter to SangStat expressing interest in exploring a potential acquisition of all of the outstanding capital stock of SangStat in a transaction structured as a merger for $20.00 per share to be paid with Genzyme General Division common stock subject to a collar limiting any increase or decrease in the number of shares of Genzyme General Division common stock to be issued. SangStat, in consultation with Merrill Lynch and Skadden, Arps, carefully reviewed and analyzed the terms of the written indications of interest. During this time period, Mr. Murdock, Mr. Stephen G. Dance, Chief Financial Officer of SangStat, Mr. Adrian

Arima, Senior Vice President and General Counsel of SangStat, Mr. Steve Aselage, Senior Vice President, North American Sales and Marketing of SangStat, Dr. Raymond J. Tesi, Senior Vice President, Clinical Development and Medical Affairs of SangStat and Mr. Brian Lundstrom, Vice President Business Development of SangStat met with various parties that submitted written indications of interest in New York City. Various members of SangStat's management team gave presentations to each of the prospective bidders, except Genzyme.

On June 17, 2003 and June 19, 2003, representatives from Merrill Lynch contacted representatives from Credit Suisse First Boston to discuss the terms of Genzyme's proposal. The parties discussed, among other things, the value of Genzyme's proposal relative to the other proposals received by SangStat. The representatives from Credit Suisse First Boston agreed to discuss Genzyme's proposal further with their client. On June 17, 2003, Genzyme also submitted a preliminary due diligence request list to SangStat.

On June 20, 2003, SangStat convened a meeting of its Board. Mr. Murdock reviewed the strategic opportunities being explored by SangStat, and Merrill Lynch updated the Board on status and terms of the continued indications of interest received by SangStat. The Board instructed management of SangStat and Merrill Lynch to continue their efforts to explore potential opportunities to sell SangStat, as well as to establish RDP58 partnership relationships, while continuing to operate SangStat in the ordinary course. Mr. Murdock and representatives from Merrill Lynch and Skadden, Arps later contacted each of the parties that submitted a written indication of interest to discuss the status of their bids and the next steps in the bidding process. Representatives of SangStat also advised those parties that the Board had not committed to sell SangStat immediately and that SangStat was considering, among other things, RDP58 partnering options in lieu of, or in addition to, a possible sale transaction. Representatives from Merrill Lynch discussed a proposed timeframe for conducting additional due diligence for the four parties that continued to express interest and that had presented proposals within a range of values that was comparable to other proposals submitted. Merrill Lynch prepared and distributed a letter to interested parties regarding the procedures for conducting additional due diligence in SangStat's data rooms to be set up in the offices of Skadden, Arps in Palo Alto and San Francisco, California.

On June 23, 2003, representatives of Merrill Lynch informed representatives of Credit Suisse First Boston that, in light of other expressions of interest, Genzyme's offer for an all-stock transaction of $20.00 per share was unlikely to be adequate.

On June 25, 2003, Mr. van Heek contacted Mr. Murdock to express Genzyme's continued interest in pursuing a potential strategic transaction. On behalf of Genzyme, representatives from Credit Suisse First Boston contacted representatives from Merrill Lynch to discuss the revised terms of Genzyme's proposal, which included increasing the offer price to $22.00 per share and changing the form of consideration to be paid to fifty percent (50%) in cash and fifty percent (50%) in Genzyme General Division common stock. Mr. Termeer sent a letter to SangStat specifying revised terms and a proposed timeframe for a potential business combination transaction.

On June 27, 2003, Messrs. Arima and Dance and representatives from Merrill Lynch and Skadden, Arps participated in a conference call with Mr. Geraghty, Ms. Tracey McCain, Vice President and Deputy General Counsel of Genzyme, other members of the Genzyme management team and representatives from Credit Suisse First Boston and Ropes & Gray LLP ("*Ropes & Gray*"), Genzyme's legal advisor, to discuss the due diligence request list submitted by Genzyme. The parties discussed areas of concern and confirmed plans for Genzyme, Credit Suisse First Boston and Ropes & Gray to visit SangStat's data room in the offices of Skadden, Arps in Palo Alto, California.

From June 30, 2003 through July 18, 2003, each of the four remaining parties, including Genzyme, were provided the opportunity to visit SangStat's data room in the offices of Skadden, Arps. Each prospective bidder brought legal, financial and accounting advisors, as well as their own respective internal management team members. SangStat's management team, including Messrs. Murdock, Dance,

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Arima, Aselage, Raysam Prasad, Senior Vice President, Worldwide Regulatory Affairs and Compliance of SangStat, Ralph Levy, Senior Vice President, Operations of SangStat, Tim Fong, Vice President, Discovery Research of SangStat, and Lundstrom, Dr. Tesi and Ms. Marlene Perry, Vice President, Human Resources of SangStat, met with each bidder, provided formal presentations and informal question and answer sessions. Merrill Lynch, Skadden, Arps and SangStat's accountants also participated in meetings with each prospective bidder and were made available to each bidder to answer questions about SangStat.

From July 7, 2003 through July 10, 2003, Ms. McCain, Mr. Geraghty, other members of the Genzyme management team, Credit Suisse First Boston and Ropes & Gray visited SangStat's data room in the offices of Skadden, Arps in Palo Alto. Mr. Geraghty and his management team met with Messrs. Murdock, Aselage, Dance, Tesi, Prasad, Levy and Lundstrom and Ms. Perry in meetings regarding each functional area of SangStat. Mr. Arima and a representative from Skadden, Arps also met with Ms. McCain and a representative from Ropes & Gray. The parties agreed to continue to work to provide information required by Genzyme to complete its due diligence.

On July 8, 2003, Messrs. Murdock, van Heek and Geraghty, along with representatives from Merrill Lynch and Credit Suisse First Boston, met to discuss SangStat's business and its strategic initiatives. Mr. Murdock provided an update on the status of discussions regarding potential partnership arrangements for SangStat's product in development, RDP58. The parties agreed to continue to explore the merits and issues associated with a potential business combination transaction. In addition, Merrill Lynch, on behalf of SangStat, prepared and distributed a letter to each of the parties that had expressed continuing interest in a business combination transaction with SangStat. The letter set forth the process and terms upon which updated offers should be submitted to SangStat. Merrill Lynch also distributed a form of merger agreement prepared by Skadden, Arps to each prospective bidder to be marked to reflect the terms of their respective proposals to acquire SangStat.

From July 14, 2003 through July 18, 2003, each of the parties that conducted due diligence in SangStat's data rooms in Palo Alto and San Francisco also visited SangStat's facility in Marcy l'Etoile, near Lyon, France. Each prospective bidder was given the opportunity to review documents related to SangStat's manufacturing operations in Marcy l'Etoile. Mr. Levy also provided representatives from each prospective bidder with a plant tour. On July 14, 2003 and July 15, 2003, Genzyme diligence team members met with Messrs. Prasad and Levy in Lyon, France and at SangStat's Marcy l'Etoile facility. Genzyme representatives were given a plant tour and the opportunity to review documents regarding the manufacturing operations in Marcy l'Etoile.

On July 17, 2003, Mr. Lundstrom and Mr. Fong visited Genzyme's headquarters in Cambridge, Massachusetts to provide a presentation regarding the humanized polyclonals development program and the RDP58 development program to the Genzyme scientific diligence team. The Genzyme team was given the opportunity to ask questions regarding the programs.

On July 20, 2003, Merrill Lynch distributed a letter establishing the deadline for interested parties to submit an updated bid to acquire SangStat. The letter requested that these bids be submitted by July 24, 2003.

On July 22, 2003, Ms. McCain and Mr. Jonathan Lloyd-Jones, Senior Director, Corporate Development of Genzyme, visited the New York City offices of Skadden, Arps to review additional documents SangStat had made available to prospective bidders.

On July 23, 2003, Mr. Geraghty and Dr. Naseem Amin, Vice President of Genzyme General, visited SangStat's offices in Fremont, California. Mr. Geraghty and Dr. Amin gave a presentation to Messrs. Murdock, Dance, Arima, Lundstrom and Aselage, as well as representatives of Merrill Lynch and Skadden, Arps, regarding Genzyme's business and its financial performance. Messrs. Murdock, Arima, Dance and Geraghty, Ms. McCain and Peter Wirth, Executive Vice President and Chief Legal Officer of Genzyme, and other Genzyme representatives and representatives of Ropes & Gray participated in a conference call to discuss certain questions Genzyme had based on their due diligence

review. Mr. Geraghty also met with Mr. Murdock and representatives of Merrill Lynch and Skadden, Arps to discuss the terms of their proposal, including the form of consideration and the structure of the business combination. Mr. Geraghty also spent time with Mr. Murdock and SangStat's management team discussing the RDP58 development program and the status of the efforts to license out RDP58.

On July 24, 2003, SangStat received updated bid proposals from the remaining interested parties, including a letter from the party that originally expressed interest on June 3rd, as well as a letter from Genzyme confirming its proposal to acquire all of the outstanding capital stock of SangStat in a transaction structured as a merger for $22.00 per share consisting of $11.00 in cash and $11.00 in shares of Genzyme General Division common stock, subject to a collar limiting the increase or decrease in the number of shares of Genzyme General Division common stock to be issued. SangStat's management team, Merrill Lynch and Skadden, Arps carefully analyzed the terms and conditions of each bid received and shared their respective analyses of the bids with Messrs. Murdock, Dance, Aselage and Arima. Representatives from Merrill Lynch and Skadden, Arps also participated in a conference call with SangStat's management to advise Messrs. Murdock, Dance, Arima and Aselage. Management determined to convene a meeting of the Board to seek their direction and guidance.

On July 27, 2003, the Board held a special meeting. Members of SangStat's management team advised the Board of partnering proposals and developments with respect to RDP58 and with respect to SangStat generally. Representatives from Merrill Lynch updated the Board on the status of the bids received for a sale transaction. After careful consideration of the information provided, the Board elected not to accept or reject any bid and instead authorized and directed Merrill Lynch to contact the remaining bidders to clarify the terms of their respective bids for SangStat and, where appropriate, to negotiate improved terms.

On July 29, 2003, representatives from Merrill Lynch, on behalf of SangStat, contacted, among others, representatives from Credit Suisse First Boston. Merrill Lynch expressed SangStat's viewpoint regarding the value and form of consideration of Genzyme's bid. Merrill Lynch and

Credit Suisse First Boston also discussed the timeframe desired by their respective clients to sign and close a potential transaction. Merrill Lynch also provided a new form of merger agreement to Credit Suisse First Boston reflecting a tender offer transaction. Mr. Paul Kinsella of Ropes & Gray also called Mr. Greg Smith of Skadden, Arps to discuss the structure, timing and form of consideration proposed. At the request of Genzyme, representatives of Credit Suisse First Boston contacted Merrill Lynch later in the evening to present revised terms reflecting an increase in the offer price to $22.50 per share to be paid through an all cash tender offer. Merrill Lynch agreed to consult with SangStat regarding the revised terms and proposed timing for Genzyme's offer.

On July 30, 2003, Messrs. Murdock, Arima, Dance, Geraghty and Wirth, Ms. McCain and other Genzyme representatives along with representatives from Merrill Lynch, Credit Suisse First Boston, Skadden, Arps and Ropes & Gray participated in a conference call to discuss Genzyme's proposed timeline and other issues related to Genzyme's proposed bid. The parties agreed to further evaluate the proposed terms of Genzyme's offer pending instructions from the Board.

Later on July 30, 2003, SangStat convened a meeting of the Board. Messrs. Murdock, Dance and Arima and representatives from Merrill Lynch and Skadden, Arps participated in a conference call. The Board reviewed the terms of Genzyme's revised proposal and discussed the status of the other interested parties. After consultation with Merrill Lynch and Skadden, Arps, the Board authorized and directed management to actively pursue further discussions with Genzyme.

From July 31, 2003 through August 1, 2003, members of the Genzyme management team visited SangStat's facility in Marcy l'Etoile, France for a second time to conduct further due diligence. Mr. Prasad met with representatives from Genzyme to provide access to additional documents and answer questions.

From August 1, 2003 through August 3, 2003, representatives from Ropes & Gray and Skadden, Arps met in the Skadden, Arps Palo Alto offices to discuss Genzyme's proposed terms to enter into a binding merger agreement. Further due diligence was conducted at this time. Representatives from Skadden, Arps and Ropes & Gray exchanged drafts and negotiated terms throughout this time period to attempt to finalize the terms of the Merger Agreement.

On August 1, 2003, Messrs. Geraghty and Murdock, along with representatives from Skadden, Arps and Ropes & Gray, met in the late afternoon in the Skadden, Arps offices. The parties discussed a brief list of business points that required resolution. After reviewing the issues, the parties adjourned their meeting, and Messrs. Geraghty and Murdock continued their discussion in a separate meeting that evening.

On August 2, 2003, representatives from Skadden, Arps and Ropes & Gray met throughout the day and continued their discussions.

On August 3, 2003, Messrs. Geraghty and Murdock met during the morning to address the remaining issues.

Conclusion

On August 3, 2003, the SangStat Board met to review and consider the Genzyme proposal. Mr. Murdock updated the Board on the status of negotiations with Genzyme, and Skadden, Arps summarized the terms of the merger agreement as presently proposed. Merrill Lynch also advised the board of the status of the other proposals. The Board then considered the possibility of remaining independent and pursuing partnering options for RDP58 then available, as described above, and compared this against the value of the sale offers received to date, including the revised Genzyme offer. In doing so, the Board considered, among other things, the various risks and benefits relating to remaining independent, including the development and other risks related to RDP58, against the benefits of the Genzyme offer, including the substantial premium, which appeared to fully reflect, among other things, the present value of the RDP58 opportunity. In this regard, the Board considered, among other things, the fact that the RDP clinical results were from early Phase II studies with small numbers of patients, that toxicology data were limited to short-term studies, and that many pharmaceutical products fail in Phase III trials. The Board also considered the comprehensive partnering and sale processes undertaken to ensure that these were the best terms available to SangStat. Thereafter, Merrill Lynch provided its financial analysis and fairness opinion to the Board. After discussion among the participants in the meeting to address questions from the Board, the Board by a unanimous vote, approved the Merger Agreement and the transactions contemplated by the Merger Agreement, including the Offer and the Merger, determined that the terms of the Offer and the Merger are fair to, and in the best interests of, SangStat and its stockholders, recommended that the stockholders of SangStat accept the Offer and tender their Shares to the Purchaser pursuant to the Offer, determined that the Merger Agreement is advisable and recommended that the stockholders of SangStat approve the Merger Agreement, to the extent such approval is required by applicable law.

On August 4, 2003, SangStat and Genzyme executed the Merger Agreement and issued a press release announcing the execution of the Merger Agreement.

On August 13, 2003, Genzyme and the Purchaser commenced the Offer.

(ii) *Reasons for the Recommendation of the Board of Directors.*

In approving the Merger Agreement and the transactions contemplated thereby, including the Offer and the Merger, and recommending that all holders of Common Stock accept the Offer and tender their shares of Common Stock pursuant to the Offer, the Board consulted with SangStat's management and its investment bankers and legal advisors, and considered a variety of factors, including the following:

Premium. The past stock price performance, price-to-earnings ratios and other financial multiples and recent trading range of the Common Stock, including the fact that the Offer Price represents (i) a premium of 45% over the $15.48 closing price of the Common Stock on the Nasdaq National Market (the "Nasdaq") on August 1, 2003, the last full trading day prior to the announcement of the Offer; (ii) a premium of approximately 58% over the average closing price of the Common Stock on the Nasdaq for the 30 days prior to the announcement of the Offer; (iii) a premium of approximately 57% over the average closing price of the Common Stock on the Nasdaq for the 12 months prior to the announcement of the Offer; and (iv) a premium of approximately 89% over the average closing price of the Common Stock on the Nasdaq during the 6 months prior to the announcement of the Offer.

Alternative Proposals. The fact that SangStat contacted a number of potential acquirers, including companies that it reasonably considered to be potential interested parties, concerning a possible business combination and that such parties were not interested in pursuing a business combination at a price per share that the Board believed to be superior to the Offer and the Merger. SangStat also considered the partnering opportunities discussed above.

Certainty of Value. The fact that the Offer and the Merger provide for a prompt cash tender offer for all the shares of Common Stock to be followed by the Merger for the same consideration, thereby enabling SangStat's stockholders, at the earliest possible time, to obtain the benefits of the transaction in exchange for their shares of Common Stock.

Opinion of Investment Banker. The Board considered the opinion of Merrill Lynch, SangStat's investment banker, dated August 3, 2003, that, as of such date and based on and subject to the matters described in the written opinion, the consideration to be received by the holders of Shares in the Offer and the Merger was fair from a financial point of view to such holders. **The full text of the written opinion of Merrill Lynch is attached as Annex A to this Statement and is incorporated herein by reference. Merrill Lynch's written opinion describes the procedures followed, assumptions made, matters considered and qualifications and limitations on the review undertaken by Merrill Lynch in connection with its opinion. SangStat stockholders are urged to read the Merrill Lynch opinion in its entirety. Merrill Lynch's written opinion is directed to the Board and only addresses the fairness of the consideration in the Offer and the Merger to SangStat stockholders from a financial point of view as of the date of the opinion. Merrill Lynch's written opinion does not address any other aspect of the Offer and the Merger and does not constitute a recommendation to any Company stockholder as to whether the stockholder should tender Shares in the Offer or vote with respect to the Merger.**

No Financing Condition. The fact that Genzyme's and the Purchaser's obligations under the Offer are not subject to any financing condition, which the Board believed would increase the likelihood of completing the transaction.

Business Prospects. The Board's familiarity with, and management's view of, SangStat's business, financial condition, results of operations, current business strategy, future business prospects, the nature of the markets in which SangStat operates, including their growth prospects, SangStat's position in such markets and the historical and current market prices for the Shares.

Fiduciary Out. The fact that SangStat may, subject to the terms of the Merger Agreement, change its recommendation at any time and, after September 15, 2003, terminate the Merger Agreement in order to approve an unsolicited tender offer or other proposed business combination by a third party that the Board determines in good faith to be superior to the Offer, if SangStat has complied with its obligation to give Genzyme notice and an opportunity to match such offer, upon the payment to Genzyme of a $22 million termination fee. In addition, the Board considered the fact that the Merger Agreement permits SangStat to provide information and participate in discussions and negotiations with respect to unsolicited acquisition proposals at any time if the Board determines in good faith that the acquisition proposal is superior to the Offer and the Merger, that taking such action is in the best interest of SangStat and its stockholders and that the failure to take such action is reasonably likely to cause the Board to violate its fiduciary duties to SangStat's stockholders.

Employee and Board Options. The fact that in the absence of an acquisition, the options held by the employees and the Board of SangStat would continue to vest in accordance with their terms and would not accelerate.

The foregoing includes the material factors considered by the Board. In view of its many considerations, the Board of Directors did not find it practical to, and did not, quantify or otherwise assign relative weights to the various individual factors considered. In addition, individual members of the Board may have given different weights to the various factors considered. After weighing all of these considerations, the Board, by a unanimous vote, approved the Merger Agreement and the transactions contemplated thereby, including the Offer and the Merger, determined that the terms of the Offer and the Merger are fair to, and in the best interests of, SangStat and holders of its Shares and recommended that holders of Shares accept the Offer and tender their Shares pursuant to the Offer.

Intent to Tender.

To the best of SangStat's knowledge, after reasonable inquiry, each executive officer, director, affiliate and subsidiary of SangStat currently intends, subject to compliance with applicable law including Section 16(b) of the Securities and Exchange Act of 1934, to tender all Shares held of record or beneficially owned by such person or entity to the Purchaser in the Offer other than such Shares, if any, that any such person or entity may have an unexercised right to purchase by exercising stock options. Outstanding stock options will become fully vested and exercisable immediately prior to the Merger and will be cancelled. Following the Merger, Genzyme or the Surviving Corporation shall pay each option holder cash in an amount equal to the product of (a) the amount, if any, by which $22.50 (or the highest price paid for any Share in the Offer) exceeds the per Share exercise price of such option holder's options and (b) the number of shares underlying such option holder's options.

Item 5. Persons/Assets Retained, Employed, Compensated or Used.

Merrill Lynch is acting as financial advisor to SangStat and will receive a customary fee for its services in connection with its engagement. SangStat has agreed to reimburse Merrill Lynch for certain expenses incurred in connection with rendering financial advisory services, including fees and disbursements of its legal counsel. SangStat also has agreed to indemnify Merrill Lynch and its directors, officers, agents, employees and controlling persons for certain costs, expenses and liabilities, including certain liabilities under the federal securities laws. In the ordinary course of business, Merrill Lynch may actively trade Shares and other securities of SangStat, as well as securities of Genzyme, for its own account and for the accounts of its customers and, accordingly, may at any time hold a long or short position in such securities.

Except as set forth above, neither SangStat nor any person acting on its behalf has or currently intends to employ, retain or compensate any person to make solicitations or recommendations to the stockholders of SangStat on its behalf with respect to the Offer, except that such solicitations or recommendations may be made by directors, officers or employees of SangStat, for which services no additional compensation will be paid.

Item 6. Interest in Securities of the Subject Company.

No transactions in Shares have been effected during the past 60 days by SangStat or any subsidiary of SangStat or, to the knowledge of SangStat, by any executive officer, director or affiliate of SangStat.

Item 7. Purposes of the Transaction and Plans or Proposals.

Except as set forth in this Statement, SangStat is not currently undertaking or engaged in any negotiations in response to the Offer that relate to (1) a tender offer for or other acquisition of SangStat's securities by SangStat, any subsidiary of SangStat or any other person; (2) an extraordinary transaction, such as a merger, reorganization or liquidation, involving SangStat or any subsidiary of SangStat; (3) a purchase, sale or transfer of a material amount of assets of SangStat or any subsidiary of SangStat; or (4) any material change in the present dividend rate or policy, or indebtedness or capitalization of SangStat.

Except as set forth in this Statement, there are no transactions, resolutions of the Board, agreements in principle, or signed contracts in response to the Offer that relate to one or more of the events referred to in the preceding paragraph.

Item 8. Additional Information.

(a) *Delaware General Corporation Law.*

Business Combination Statute. As a Delaware corporation, SangStat is subject to Section 203 of the Delaware General Corporation Law ("*DGCL*"). In general, Section 203 of the DGCL would prevent an "interested stockholder" (generally defined as a person beneficially owning 15% or more of a corporation's voting stock) from engaging in a "business combination" (as defined in Section 203 of the DGCL) with a Delaware corporation for three years following the date such person became an interested stockholder unless: (1) before such person became an interested stockholder, the board of directors of the corporation approved the transaction in which the interested stockholder became an interested stockholder or approved the business combination, (2) upon consummation of the transaction which resulted in the interested stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced (excluding for purposes of determining the number of shares of outstanding stock held by directors who are also officers and by employee stock plans that do not allow plan participants to determine confidentially whether to tender shares), or (3) following the transaction in which such person became an interested stockholder, the business combination is (x) approved by the board of directors of the corporation and (y) authorized at a meeting of stockholders by the affirmative vote of the holders of at least $66^2/_3\%$ of the outstanding voting stock of the corporation not owned by the interested stockholder. In accordance with the provisions of Section 203, the Board of Directors has approved the Merger Agreement and the transactions contemplated thereby, as described in Item 4 above and, therefore, the restrictions of Section 203 are inapplicable to the Merger and the transactions contemplated under the Merger Agreement.

Appraisal Rights. Stockholders do not have appraisal rights as a result of the Offer. However, if the Merger is consummated, each holder of Shares (that did not tender such holder's Shares in the Offer) at the Effective Time who has neither voted in favor of the Merger nor consented thereto in writing, and who otherwise complies with the applicable statutory procedures under Section 262 of the

DGCL will be entitled to receive a judicial determination of the fair value of the holder's Shares (exclusive of any element of value arising from the accomplishment or expectation of such merger or similar business combination) and to receive payment of such fair value in cash, together with a fair rate of interest, if any, for Shares held by such holder. Any such judicial determination of the fair value of the Shares could be based upon considerations other than or in addition to the price paid in the Offer and the market value of the Shares. Stockholders should recognize that the value so determined could be higher or lower than the price per Share paid pursuant to the Offer. Moreover, SangStat may argue in an appraisal proceeding that, for purposes of such a proceeding, the fair value of the Shares is less than the price paid in the Offer. The foregoing discussion is not a complete statement of law pertaining to appraisal rights under Delaware law and is qualified in its entirety by reference to Delaware law.

If any holder of Shares who demands appraisal under Section 262 of the DGCL fails to perfect, or effectively withdraws or loses his, hers, or its rights to appraisal as provided in the Delaware Law, the Shares of such stockholder will be converted into the right to receive the Merger Consideration in accordance with the Merger Agreement. A stockholder may withdraw a demand for appraisal by delivering to SangStat a written withdrawal of the demand for appraisal and acceptance of the Merger.

Failure to follow the steps required by Section 262 of the DGCL for perfecting appraisal rights may result in the loss of such rights.

Short-form Merger. Under Section 253 of the DGCL, if the Purchaser acquires, pursuant to the Offer or otherwise, at least 90% of the outstanding Shares, the Purchaser will be able to effect the Merger after consummation of the Offer without a vote of SangStat's stockholders. However, if the Purchaser does not acquire at least 90% of the Shares pursuant to the Offer or otherwise and a vote of SangStat's stockholders is required under Delaware law, a significantly longer period of time will be required to effect the Merger.

(b) *Regulatory Approvals.*

United States. Genzyme and SangStat are each required to file a Notification and Report Form with respect to the Offer under the HSR Act prior to completing the Offer. Under the provisions of the HSR Act applicable to the Offer, the acquisition of Shares pursuant to the Offer may be consummated after the expiration of a 15-calendar day waiting period commenced by the filing of a Notification and Report Form with respect to the Offer, unless Genzyme receives a request for additional information or documentary material from the Antitrust Division of the Department of Justice or the Federal Trade Commission (the *"FTC"*) or unless early termination of the waiting period is granted. Genzyme and SangStat are in the process of preparing such filings. If, within the initial 15-day waiting period, either the Antitrust Division or the FTC requests additional information from Genzyme concerning the Offer, the waiting period will be extended and would expire at 11:59 p.m., New York City time, on the tenth calendar day after the date of substantial compliance by Genzyme with such request. Only one extension of the waiting period pursuant to a request for additional information is authorized by the HSR Act. Thereafter, such waiting period may be extended only by court order or with the consent of Genzyme. In practice, complying with a request for additional information or material can take a significant amount of time. In addition, if the Antitrust Division or the FTC raises substantive issues in connection with a proposed transaction, the parties frequently engage in negotiations with the relevant governmental agency concerning possible means of addressing those issues and may agree to delay consummation of the transaction while such negotiations continue. Expiration or termination of the applicable waiting period under the HSR Act is a condition to the Purchaser's obligation to accept for payment and pay for Shares tendered pursuant to the Offer.

The Merger will not require an additional filing under the HSR Act if the Purchaser owns 50% or more of the outstanding Shares at the time of the Merger or if the Merger occurs within one year after the HSR Act waiting period applicable to the Offer expires or is terminated.

The Antitrust Division and the FTC frequently scrutinize the legality under the antitrust laws of transactions such as the Purchaser's proposed acquisition of SangStat. At any time before or after the Purchaser's acquisition of Shares pursuant to the Offer, the Antitrust Division or the FTC could take such action under the antitrust laws as it deems necessary or desirable in the public interest, including seeking to enjoin the purchase of Shares pursuant to the Offer or the consummation of the Merger or seeking the divestiture of Shares acquired by the Purchaser or the divestiture of substantial assets of SangStat or its subsidiaries or Genzyme or its subsidiaries. Private parties, including state Attorneys General, may also bring legal action under the antitrust laws under certain circumstances. There can be no assurance that a challenge to the Offer on antitrust grounds will not be made or, if such a challenge is made, of the result thereof.

Germany. Under the provisions of the German AARC applicable to the Offer, the acquisition of the Shares pursuant to the Offer may be consummated one month after Genzyme and SangStat submit a joint pre-merger notification to Germany's Federal Cartel Office (the *"FCO"*) with respect to the Offer (a *"first stage investigation"*), unless the FCO determines to subject the Offer to further investigation (a *"second stage investigation"*) or unless the FCO otherwise consents. Genzyme and SangStat are in the process of preparing their pre-merger notification to the FCO.

Where it is clear to the FCO that a transaction will not pose substantive competition problems in Germany, the FCO generally issues a clearance letter during the first stage investigation. This first stage clearance is not subject to appeal by third parties. In connection with a second stage investigation, however, the FCO must render a reasoned clearance decision and such decision may be appealed by any interested third parties that have been admitted to the proceedings. The FCO may take up to four months (first and second stage investigations taken together) after a pre-merger notification is submitted to investigate and possibly challenge a transaction, and may take additional time to do so if the relevant parties consent to such extension. There can be no assurance that a challenge to the Offer under German law on competition or other grounds will not be made or, if such a challenge is made, of the results thereof.

Expiration or termination of the applicable waiting period under the German AARC is a condition to the Purchaser's obligation to accept for payment and pay for Shares tendered pursuant to the Offer.

Other Foreign Jurisdictions. It may be necessary to make additional filings relating to the acquisition of the Shares pursuant to the Offer or the Merger with governmental entities in other foreign jurisdictions. Genzyme and SangStat are reviewing whether any such filings are required in connection with the Offer or the Merger and intend to make such filings promptly to the extext required. There can be no assurance that such governmental entities will not challenge the acquisition of the Shares on competition or other grounds or, if such a challenge is made, of the results thereof.

(c) *Litigation.*

On August 7, 2003, a putative shareholder class action was filed in the California Superior Court, County of Alameda, purportedly on behalf of holders of SangStat's common stock, under the caption *Pignone v. SangStat Medical Corp., et al.,* (Case No. RG 03110801). The Plaintiff names as defendants in the action SangStat and each of SangStat's current directors. Plaintiff asserts a single cause of action under Delaware law claiming that SangStat and each of its directors has breached fiduciary duties to SangStat stockholders by consenting to the proposed sale of SangStat to Genzyme Corporation on the terms announced in SangStat's August 4, 2003 press release entitled "Genzyme to Acquire SangStat Medical Corporation," previously reported on a Form 8-K filed by SangStat on August 4, 2003. Plaintiffs allege that they do not seek monetary damages but instead seek only equitable relief, including a declaration by the Court that the agreement between SangStat and Genzyme was entered into in breach of the fiduciary duties of the defendants and is therefore unlawful and unenforceable, an order enjoining the consummation of the transaction and directing the defendants to exercise their fiduciary duties to obtain a transaction in the best interests of SangStat stockholders and an order

rescinding the transaction to the extent already implemented. Plaintiff also seeks costs of suit, including attorneys' fees.

The foregoing description of the complaint is qualified in its entirety by reference to the complaint itself, which is Exhibit (e)(4) hereto and is incorporated herein by reference.

(d) *Section 14(f) Information Statement.*

The Information Statement attached as Annex B hereto is being furnished in connection with the possible designation by Genzyme, pursuant to the terms of the Merger Agreement, of certain persons to be elected to the Board of Directors other than at a meeting of SangStat's stockholders.

Item 9. Material to be Filed as Exhibits.

The following Exhibits are filed herewith:

Exhibit No.	Description
(a)(1)	Letter to the stockholders of SangStat, dated August 13, 2003.
(a)(2)	Form of Letter of Transmittal.+
(a)(3)	Opinion of Merrill Lynch, dated as of August 3, 2003 (included as Annex A to this Statement).
(a)(4)	Joint Press Release issued by Genzyme and SangStat on August 4, 2003 (incorporated by reference to Company's Current Report on Form 8-K filed August 4, 2003).
(e)(1)	Agreement and Plan of Merger, dated as of August 4, 2003, among Genzyme, Purchaser and SangStat (incorporated by reference to Exhibit 2.1 to the Form 8-K filed by SangStat on August 4, 2003).
(e)(2)	Information Statement of SangStat, dated August 13, 2003 (included as Annex B hereto).
(e)(3)	Confidentiality Agreement dated June 12, 2003 between Genzyme and SangStat.
(e)(4)	Complaint, R. Pignone v. SangStat Medical Corporation, Jean-Jacques Bienaimé, Fredric J. Feldman, Corinne H. Lyle, Richard D. Murdock, Andrew J. Perlman, Hollings C. Renton, III et al., Case No. RG03110801, Superior Court of the State of California, County of Alameda, filed August 7, 2003.

+ Incorporated by reference to Schedule TO filed by Swift Starboard Corporation and Genzyme Corporation on August 13, 2003.

SIGNATURE

After due inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

SANGSTAT MEDICAL CORPORATION

By: /s/ RICHARD D. MURDOCK

Name: Richard D. Murdock
Title: Chairman, President and Chief Executive Officer

Dated: August 13, 2003

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ANNEX A

[Letterhead of Merrill Lynch]

August 3, 2003

Board of Directors
SangStat Medical Corporation
6300 Dumbarton Circle
Fremont, CA 94555

Members of the Board of Directors:

SangStat Medical Corporation (the "Company"), and Genzyme Corporation (the "Acquiror") and Swift Starboard Corporation, a newly formed, wholly owned subsidiary of the Acquiror (the "Acquisition Sub"), propose to enter into Agreement and Plan of Merger dated August 4, 2003 (the "Agreement") pursuant to which (i) the Acquiror and the Acquisition Sub would commence a tender offer (the "Tender Offer") for all outstanding shares of the Company's common stock, par value $0.001 per share, of the Company (the "Company Shares") for $22.50 per share, net to the seller in cash (the "Consideration"), and (ii) Acquisition Sub would be merged with the Company in a merger (the "Merger"), in which each Company Share not acquired in the Tender Offer, other than Company Shares held in treasury or held by the Acquiror or any affiliate of the Acquiror or as to which dissenter's rights have been perfected, would be converted into the right to receive the Consideration. The Tender Offer and the Merger, taken together, are referred to as the "Transaction."

You have asked us whether, in our opinion, the Consideration to be received by the holders of the Company Shares pursuant to the Transaction is fair from a financial point of view to such holders.

In arriving at the opinion set forth below, we have, among other things:

(1) Reviewed certain publicly available business and financial information relating to the Company that we deemed to be relevant;

(2) Reviewed certain information, including financial forecasts, relating to the business, earnings, cash flow, assets, liabilities and prospects of the Company furnished to us by the Company;

(3) Conducted discussions with certain members of senior management and representatives of the Company made available to us concerning the matters described in clauses 1 and 2 above;

(4) Reviewed the market prices and valuation multiples for the Company Shares and compared them with those of certain publicly traded companies that we deemed to be relevant;

(5)

Reviewed the results of operations of the Company and compared them with those of certain publicly traded companies that we deemed to be relevant;

(6) Compared the proposed financial terms of the Transaction with the financial terms of certain other transactions that we deemed to be relevant;

(7) Participated in certain discussions and negotiations among representatives of the Company and the Acquiror and their financial and legal advisors;

(8) Reviewed a draft dated August 3, 2003 of the Agreement; and

(9) Reviewed such other financial studies and analyses and took into account such other matters as we deemed necessary, including our assessment of general economic, market and monetary conditions.

In preparing our opinion, we have assumed and relied on the accuracy and completeness of all information supplied or otherwise made available to us, discussed with or reviewed by or for us, or

publicly available, and we have not assumed any responsibility for independently verifying such information or undertaken an independent evaluation or appraisal of any of the assets or liabilities of the Company or been furnished with any such evaluation or appraisal, nor have we evaluated the solvency or fair value of the Company under any state or federal laws relating to bankruptcy, insolvency or similar matters. In addition, we have not assumed any obligation to conduct any physical inspection of the properties or facilities of the Company. With respect to the financial forecast information furnished to or discussed with us by the Company, we have assumed that they have been reasonably prepared and reflect the best currently available estimates and judgment of the Company's management as to the expected future financial performance of the Company. We have also assumed that the final form of the Agreement will be substantially similar to the last draft reviewed by us. We have further assumed that the Transaction will be consummated in accordance with the terms of the Agreement without waiver of any of the conditions precedent to the Transaction contained in the Agreement.

Our opinion is necessarily based upon market, economic and other conditions as they exist and can be evaluated on, and on the information made available to us as of, the date hereof.

We are acting as financial advisor to the Company in connection with the Transaction and will receive a fee from the Company for our services, substantially all of which is contingent upon the consummation of the Transaction. In addition, the Company has agreed to indemnify us for certain liabilities arising out of our engagement. We have, in the past, provided financial advisory and financing services to the Company and the Acquiror and/or its affiliates and may continue to do so and have received, and may receive, fees for the rendering of such services. We regularly publish research reports regarding the biopharmaceutical industry and publicly owned companies in that industry, and we have published research reports regarding the Company. In addition, in the ordinary course of our business, we may actively trade the Company Shares and other securities of the Company, as well as securities of the Acquiror for our own account and for the accounts of customers and, accordingly, may at any time hold a long or short position in such securities.

This opinion is for the use and benefit of the Board of Directors of the Company. Our opinion does not address the merits of the underlying decision by the Company to engage in the Transaction and does not constitute a recommendation to any shareholder as to whether such shareholder should tender any Company Shares pursuant to the Tender Offer and how such shareholder should vote on the proposed Merger or any matter related thereto. In addition, you have not asked us to address, and this opinion does not address, the fairness to, or any other consideration of, the holders of any class of securities, creditors or other constituencies of the Company, other than the holders of the Company Shares.

On the basis of and subject to the foregoing, we are of the opinion that, as of the date hereof, the Consideration to be received by the holders of the Company Shares pursuant to the Transaction is fair from a financial point of view to the holders of such shares.

Very truly yours,

MERRILL LYNCH, PIERCE, FENNER & SMITH

INCORPORATED

ANNEX B

SANGSTAT MEDICAL CORPORATION
6300 DUMBARTON CIRCLE
FREMONT, CALIFORNIA 94555

INFORMATION STATEMENT PURSUANT TO
SECTION 14(F) OF THE SECURITIES EXCHANGE ACT
OF 1934 AND RULE 14F-1 THEREUNDER

This Information Statement is being mailed on or about August 13, 2003 as part of the Solicitation/Recommendation Statement on Schedule 14D-9 (the "*Statement*") of SangStat Medical Corporation ("*SangStat*"). You are receiving this Information Statement in connection with the possible election of persons designated by Genzyme Corporation ("*Genzyme*") to a majority of seats on the Board of Directors (the "*Board of Directors*" or the "*Board*") of SangStat. On August 4, 2003, SangStat entered into an Agreement and Plan of Merger (the "*Merger Agreement*") with Genzyme and Swift Starboard Corporation (the "*Purchaser*"), a Delaware corporation and a wholly-owned subsidiary of Genzyme, pursuant to which the Purchaser has commenced a tender offer to purchase each issued and outstanding share of common stock, par value $.001 per share, of SangStat (the "*Common Stock*"), including the associated preferred stock purchase rights (the "*Company Rights*") issued pursuant to the Rights Agreement dated as of August 14, 1995, between SangStat and Equiserve Trust Company N.A., as rights agent, as amended from time to time (each, a "*Share*"), for $22.50 net to the seller in cash (the "*Offer Price*") upon the terms and subject to the conditions set forth in the Merger Agreement, the Offer to Purchase dated August 13, 2003 (as amended or supplemented from time to time, the "*Offer to Purchase*") and the related Letter of Transmittal (the "*Letter of Transmittal*" which, together with the Offer to Purchase, as amended or supplemented from time to time constitute the "*Offer*"). Copies of the Offer to Purchase and the Letter of Transmittal have been mailed to stockholders of SangStat and are filed as Exhibits (a)(1) and (a)(2), respectively, to the Tender Offer Statement on Schedule TO (as amended from time to time, the "*Schedule TO*") filed by Genzyme and the Purchaser with the Securities and Exchange Commission (the "*Commission*") on August 13, 2003. The Merger Agreement provides that, subject to the satisfaction or waiver of certain conditions, as soon as practicable after the completion of the Offer, and in accordance with the Delaware General Corporation Law (the "*DGCL*"), the Purchaser will be merged with and into SangStat with SangStat surviving the Merger (such surviving corporation is sometimes referred to as the "*Surviving Corporation*" and such merger is referred to as the "*Merger*"). At the effective time of the Merger (the "*Effective Time*"), each issued and outstanding share of common stock, par value $0.001 per share, of the Purchaser shall be converted into one fully paid and nonassessable share of the Surviving Corporation, all Shares that are owned by SangStat as treasury stock and any Shares owned by Genzyme or Purchaser shall be cancelled and retired and shall cease to exist and all other issued and outstanding Shares (other than Dissenting Shares) shall be converted into the right to receive the Offer Price, without interest (the "*Merger Consideration*"). Shares held by stockholders who have not voted in favor of the Merger or consented thereto in writing and who have properly demanded appraisal and complied with the provisions of Section 262 of the DGCL relating to dissenters' rights of appraisal (the "*Dissenting Shares*") shall not be converted into a right to receive the Merger Consideration, unless such holder fails to perfect or withdraws or otherwise loses his, her or its right to appraisal.

The Offer, the Merger, and the Merger Agreement are more fully described in the Statement, to which this Information Statement forms Annex B, which was filed by SangStat with the Commission on August 13, 2003 and which is being mailed to stockholders of SangStat along with this Information Statement.

This Information Statement is being mailed to you in accordance with Section 14(f) of the Securities Exchange Act of 1934 ("*Exchange Act*") and Rule 14f-1 promulgated thereunder. The information set forth herein supplements certain information set forth in the Statement. Information set forth herein related to Genzyme, the Purchaser or the Genzyme Designees (as defined below) has been provided by Genzyme. You are urged to read this Information Statement carefully. You are not, however, required to take any action in connection with the matters set forth herein.

Pursuant to the Merger Agreement, the Purchaser commenced the Offer on August 13, 2003. The Offer is currently scheduled to expire at 12:00 AM, New York City time, on Wednesday, September 10, 2003 unless the Purchaser extends it.

GENERAL

The Common Stock is the only class of equity securities of SangStat outstanding which is entitled to vote at a meeting of the stockholders of SangStat. Each share has one vote. As of the close of business on June 30, 2003, there were 26,469,087 outstanding Shares.

RIGHTS TO DESIGNATE DIRECTORS AND GENZYME DESIGNEES

The Merger Agreement provides that, upon the purchase of and payment for Shares by the Purchaser pursuant to the Offer, Genzyme will be entitled to designate such number of directors (the "*Genzyme Designees*") on the Board, rounded up to the next whole number, as is equal to the product obtained by multiplying the total number of directors on the Board by the percentage that the number of Shares beneficially owned by Genzyme and its affiliates bears to the total number of Shares then outstanding.

Additionally, the Merger Agreement provides that SangStat will take all actions necessary to cause the Genzyme Designees to be elected to the Board, including increasing the number of directors and obtaining resignations of incumbent directors. The Merger Agreement also provides that SangStat will, subject to applicable law and stock exchange regulations, take all actions requested by Genzyme to cause Genzyme Designees to constitute the number of members, rounded up to the next whole number, on (1) each committee of the Board and (2) each board of directors of each subsidiary of SangStat and each committee of such boards of directors that represents the same percentage as such individuals represent on the Board of Directors.

Notwithstanding the foregoing, if Shares are purchased pursuant to the Offer, until the Effective Time of the Merger, SangStat will cause the Board of Directors to have at least three directors who were directors on the date of the Merger Agreement and who are not officers of SangStat (the "*Independent Directors*"), provided that if the number of Independent Directors shall be reduced below three for any reason whatsoever, any remaining Independent Directors (or Independent Director, if there shall be only one remaining) shall be entitled to designate persons to fill such vacancies who shall be deemed to be Independent Directors for purposes of the Merger Agreement or, if no Independent Directors then remain, the other directors shall designate three persons to fill such vacancies who are not officers or affiliates of SangStat, Genzyme or the Purchaser, and such persons shall be deemed to be Independent Directors for purposes of the Merger Agreement. Notwithstanding anything in the Merger Agreement to the contrary, if the Genzyme Designees constitute a majority of SangStat Board of Directors after the acceptance for payment of Shares pursuant to the Offer and prior to the Effective Time, then the affirmative vote of a majority of the Independent Directors (or if only one exists, then the vote of such Independent Director) shall be required to (i) amend or terminate the Merger Agreement by SangStat, (ii) exercise or waive any of SangStat's rights, benefits or remedies thereunder, if such action would materially and adversely affect holders of Shares other than Genzyme or the Purchaser, (iii) amend the Certificate of Incorporation or Bylaws of SangStat, or (iv) take any other action of the SangStat Board of Directors under or in connection with the Merger Agreement or the Merger; provided, however, that if there shall be no Independent Directors as a result of such persons' deaths, disabilities or refusal to serve, then such actions may be effected by majority vote of the entire Company Board of Directors.

The Genzyme Designees will be selected by Genzyme from among the individuals listed below. Each of the following individuals has consented to serve as a director of SangStat if appointed or elected. If necessary, Genzyme may choose additional or other Genzyme Designees, subject to the requirements of Rule 14f-1. None of the Genzyme Designees currently is a director of, or holds any positions with, SangStat. Genzyme has advised SangStat that, to the best of Genzyme's knowledge, except as set forth below, none of the Genzyme Designees or any of their affiliates beneficially owns any equity securities or rights to acquire any such securities of SangStat, nor has any such person been involved in any transaction with SangStat or any of its directors, executive officers or affiliates that is required to be disclosed pursuant to the rules and regulations of the Commission other than with respect to transactions between Genzyme and SangStat that have been described in the Offer to Purchase or the Statement.

The name, citizenship, present principal occupation or employment and five-year employment history of each of the individuals who may be selected as Genzyme Designees are set forth below. Unless otherwise indicated, (1) the business address of each such person is Genzyme Corporation, One Kendall Square, Cambridge, MA 02139 and (2) each such person is a citizen of the United States.

G. Jan van Heek

Mr. van Heek is an Executive Vice President of Genzyme Corporation. Mr. van Heek joined Genzyme Corporation in September 1991 as General Manager of its wholly-owned subsidiary, Genzyme, B.V., and became a corporate Vice President and President of its therapeutics business unit in December 1993. From September 1996 through July 1997, he served as Group Senior Vice President, Therapeutics and from July 1997 through December 1999 served as Executive Vice President, Therapeutics and Tissue Repair. Since January 2000, he has served as Executive Vice President, Therapeutics and Genetics, with responsibility for Genzyme Corporation's Therapeutics, Renal and Genetics business units and international operations. He also is responsible for Genzyme's pharmaceuticals business. Prior to joining Genzyme, Mr. van Heek was Vice President/General Manager of the Fenwal Division of Baxter Healthcare Corporation.

Peter Wirth

Mr. Wirth is the Chief Legal Officer, Executive Vice President, Legal, Corporate Development and Drug Discovery and Development and the Clerk of Genzyme Corporation. Mr. Wirth joined Genzyme Corporation in January 1996 and has served as Executive Vice President and Chief Legal Officer since September 1996. Mr. Wirth has responsibility for Genzyme Corporation's corporate development and legal activities, Genzyme Molecular Oncology and Genzyme Corporation's GelTex Pharmaceuticals subsidiary. From January 1996 to September 1996, Mr. Wirth served as Senior Vice President and General Counsel of Genzyme Corporation. Mr. Wirth was a partner of Palmer & Dodge LLP, a Boston, Massachusetts law firm, from 1982 through September 1996. Mr. Wirth remains of counsel to Palmer & Dodge LLP.

Michael S. Wyzga

Mr. Wyzga is the Chief Financial and Accounting Officer and Executive Vice President, Finance of Genzyme Corporation. Mr. Wyzga joined Genzyme Corporation in February 1998 as Vice President and Corporate Controller, served as Senior Vice President, Corporate Controller and Chief Accounting Officer since January 1999, and as Senior Vice President, Finance and Chief Financial Officer since July 1999. Prior to joining Genzyme Corporation, from February 1997 to February 1998, Mr. Wyzga served as Chief Financial Officer of Sovereign Hill Software, Inc. (100 Venture Way, Hadley, Massachusetts 01035), a software company, and from 1991 through 1997 held various senior management positions with CACHELINK Corporation and Lotus Development Corporation.

Richard Douglas, Ph.D.

Dr. Douglas is the Senior Vice President, Corporate Development and an officer of Genzyme Corporation and has served in that role since 1996. From 1989 to 1996, Dr. Douglas was the Vice President, Corporate Development of Genzyme Corporation. From 1982 until its merger with Genzyme Corporation in 1989, Dr. Douglas served in science and corporate development capacities at Integrated Genetics, a biotechnology company. Dr. Douglas serves as a director of Iomai Corporation, a private biopharmaceutical company.

James A. Geraghty

Mr. Geraghty is Senior Vice President of International Development and an officer of Genzyme Corporation, where he was earlier President of Genzyme Europe. He also serves as a Director of GTC Biotherapeutics, where he was Chairman from 1998 to 2001, and President and Chief Executive Officer from its founding in February 1993 until 1998. Mr. Geraghty joined Genzyme Corporation in September 1992, where he held the posts of Vice President Corporate Development and General Manager of the transgenics business unit until it was spun off into GTC Biotherapeutics. He also serves as a member of the Advisory Board of the KBC Biotech Fund, based in Brussels.

OWNERSHIP OF COMMON STOCK BY THE PRINCIPAL STOCKHOLDERS AND MANAGEMENT

Security ownership of certain beneficial owners and management

The following table sets forth certain information with respect to the beneficial ownership of SangStat common stock as of June 30, 2003, except as otherwise indicated, by (a) each director; (b) SangStat's chief executive officer and its other executive officers (the "*Named Executive Officers*"); (c) each person, or group of affiliated persons that SangStat knows to beneficially own 5% or more of the outstanding shares of SangStat common stock; and (d) all directors and executive officers as a group.

Except as otherwise noted, the address of each person listed in the table is c/o SangStat Medical Corporation, 6300 Dumbarton Circle, Fremont, CA 94555.

Beneficial ownership is determined in accordance with the rules of the Commission and includes voting or investment power with respect to securities. In computing the number of shares beneficially owned by a person and the percentage of ownership of that person, shares of common stock subject to options held by that person that are currently exercisable or exercisable within 60 days of June 30, 2003 are deemed outstanding. These shares, however, are not deemed outstanding for the purposes of computing the percentage of ownership of any other person. To SangStat's knowledge, except as otherwise noted, the persons named in the table have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them, subject to community property laws where applicable.

Name and Address of Beneficial Owner	**Number of Shares Owned Beneficially (1)(2)**	**Percent of Shares Beneficially Owned**
Wellington Management Company, LLP 75 State Street, 19th Floor, Boston, MA 02109	3,701,000	14%
OrbiMed Advisors Inc. 767 3rd Avenue, 6th Floor, New York, NY 10017-2023	1,711,000	6.5%
Quaker Capital Management Corporation 401 Wood Street, 1300 Arrott Building Pittsburgh, PA 15222	1,763,000	6.7%
Fredric J. Feldman, Ph.D.	67,091	*
Richard D. Murdock	123,162	*
Andrew J. Perlman, M.D., Ph.D.	62,648	*
Hollings C. Renton III	5,937	*
Jean-Jacques Bienaimé	377,166	1.4%
Corinne H. Lyle	5,345	*
Steve Aselage	87,350	*
Stephen G. Dance	88,261	*
Raymond J. Tesi, M.D.	136,490	*
Robert Floc'h (3)	48,295	*
All directors and officers as a group (13 persons)	1,143,071	4.1%

* Less than 1% of the outstanding shares of common stock.

(1) This table is based upon information supplied by officers, directors and principal stockholders and Schedules 13D and 13G, if any, filed with the Commission. Unless otherwise indicated in the footnotes to this table and subject to community property laws where applicable, we believe that each of the stockholders named in this table has sole voting and investment power with respect to the shares indicated as beneficially owned. Applicable percentages are based on 26,469,087 outstanding shares on June 30, 2003 adjusted as required by rules promulgated by the SEC.

(2) The following table indicates those people whose total number of beneficially owned shares include shares subject to options exercisable within 60 days of June 30, 2003.

	Shares Subject to Options
Fredric J. Feldman, Ph.D.	67,091
Richard D. Murdock	118,162
Andrew J. Perlman, M.D., Ph.D.	62,648
Hollings C. Renton III	5,937
Jean-Jacques Bienaimé	377,166

	Shares Subject to Options
Corinne H. Lyle	5,145
Steve Aselage	85,469
Stephen G. Dance	88,261
Raymond J. Tesi, M.D.	131,490
Robert Floc'h	29,295

(3) Ceased to be an officer effective December 31, 2002.

BOARD OF DIRECTORS

At each annual meeting of stockholders, the nominees for director stand for election for a one-year term. Biographical information on each director, including his or her age follows:

Richard D. Murdock, 55, was appointed Chairman, President and Chief Executive Officer in October 2002. The appointment was made on an interim basis, and on March 27, 2003, the Board of Directors removed the interim status. Mr. Murdock has been a director since October 1993. Previously, Mr. Murdock was a biotechnology management consultant. From October 2001 to March 2002, Mr. Murdock was a Director and the acting President, Chief Executive Officer of InPro Biotechnology, a biotechnology company involved in the diagnosis and treatment of neurodegenerative diseases. From December 1998 until March 2001, Mr. Murdock was the President and Chief Executive Officer and a director of Kyphon, Inc., an orthopedic medical device company. From September 1991 to October 1998, Mr. Murdock served as the Chief Executive Officer and a director of CellPro, Incorporated, a public biotechnology company. Mr. Murdock received his B.S. in Zoology from the University of California at Berkeley.

Jean-Jacques Bienaimé, 49, has been a director since 1998. He joined Genencor International, Inc., a public biotechnology company, as President, Chief Executive Officer and director in November 2002. Before joining Genencor, Mr. Bienaimé was SangStat's President from June 1998 and became Chief Executive Officer in February 1999. He also served as SangStat's Chief Operating Officer from June 1998 to February 1999. He was elected to the Board of Directors in March 1999 and became Chairman of the Board of Directors in October 2000. From September 1992 to May 1998 Mr. Bienaimé was with Rhone Poulenc Rorer, Inc., a pharmaceutical company, rising to the position of Senior Vice President, Corporate Marketing and Business Development. He is currently a member of the board of Fox Chase Cancer Center and AeroGen, Inc., a public drug delivery company. Mr. Bienaimé received his degree in economics from Ecole Superieure de Commerce de Paris in France and an M.B.A. from the Wharton School, University of Pennsylvania.

Fredric J. Feldman, 62, Ph.D. has been a director since March 1992. He has been the President of FJF Associates, a consultant to health care venture capital and emerging companies, since February 1992. From September 1995 to June 1996 he was the Chief Executive Officer of Biex, Inc. a women's healthcare company. Dr. Feldman returned to his position as Chief Executive Officer of Biex from 1999 to 2000. He is a director of OrthoLogic Corporation a public medical device company. Prior to its acquisition in 2003, Dr. Feldman was a director of Ostex International, Inc., a public medical device company. Dr. Feldman received his Ph.D. in Analytical Chemistry from the University of Maryland and his B.S. in Chemistry from Brooklyn College of City University of New York.

Corinne H. Lyle, 42, became a director in July 2002. In March 2003, Ms. Lyle joined Edwards Lifesciences Corporation as Corporate Vice President and Chief Financial Officer. From 1998 to 2003, she was Vice President and CFO at Tularik Inc., a public biotechnology company, and was directly responsible for its 1999 IPO and 2000 and 2002 follow-on offerings. Prior to Tularik, she was an Executive Director in the Health Care Group at Warburg Dillon Read from 1996 to 1998. From 1994 to 1996, she served as a Senior Vice President at Paine Webber's Health Care Group. Ms. Lyle received her M.B.A. from Harvard, and a B.S. in Industrial Engineering from Stanford.

Andrew J. Perlman, 55, M.D., Ph.D. has been a director since December 1992. Since September 1999, Dr. Perlman has been Executive Vice President at Tularik, Inc., a public biotechnology company, except for a short tenure in 2002 when he served as Chief Executive Officer and a director of Affymax, Inc., a privately held biopharmaceutical company. From November 1997 to September 1999, Dr. Perlman was Tularik's Vice President, Medical Research and Corporate Development. From January 1993 to November 1997, Dr. Perlman served as Tularik's Vice President of Medical Research. Dr. Perlman received his M.D. and his Ph.D. in Physiology from New York University.

Hollings C. Renton III, 56, has been a director since May 2002. He has served as the President and Chief Executive Officer of Onyx Pharmaceuticals, Inc., a public biotechnology company, since March 1993. He has served on its Board since 1992 and currently is the Chairman. Prior to joining Onyx, Mr. Renton served as President and Chief Operating Officer of Chiron Corporation, a public biotechnology company, from December 1991 following Chiron Corporation's acquisition of Cetus Corporation, a biopharmaceutical company. He is also a director of Cepheid, a public DNA diagnostics company. Mr. Renton holds a B.S. in Mathematics from Colorado State University and an M.B.A. from the University of Michigan.

Director Compensation

Cash Compensation. Directors who are also employees do not receive additional compensation for serving as Directors. Non-employee Directors receive an annual retainer of $15,000, paid in one installment at the last Board of Directors meeting of the year. Until September 2002, non-employee Directors received $500 for each committee meeting attended that exceeded one hour in length and no additional compensation for shorter committee meetings. Effective September 2002, the non-employee Directors receive a payment of $1,000 for each committee meeting attended in person and $500 for teleconferenced meetings. No additional compensation is paid for meeting attendance or committee membership.

Stock Option Grant. Other than the Genzyme Designees, each non-employee Director elected to the Board of Directors for the first time will automatically receive upon election an initial grant of options to purchase 19,000 shares of common stock at fair market value on the date of grant as well as an annual grant of options to purchase 8,000 shares for each year during the director's term, provided such individual has served as a Board member for at least twenty-four months. The foregoing award of options are granted automatically under the 1996 Non-Employee Directors Stock Option Plan. All of the foregoing options have a ten-year term. The initial option grant vests 25% upon completion of one year of Board service and the balance vests in 36 equal monthly installments. Unvested options will vest upon the effectiveness of the Merger, pursuant to the 1996 Non-Employee Directors Stock Option Plan. The annual options vest immediately. Additionally, Directors may elect to convert their annual retainer payment into a stock option grant.

2002 Board Meetings

During the fiscal year ended December 31, 2002, the Board of Directors held eleven (11) meetings. Each Board member nominated for election attended 75% or more of the aggregate of the meetings of the Board of Directors and of the committees on which he or she served that were held during the period for which he or she was a director or committee member, respectively.

SangStat's Board of Directors has four committees: the Audit Committee, the Compensation Committee, the Nominating Committee and the Search Committee. During 2002, the Compensation Committee held three meetings. The Audit Committee held seven meetings during 2002. The Nominating Committee held no meetings during 2002, but acted by written consent. The Search Committee held two meetings during 2002.

Board Committees

The Audit Committee reviews internal accounting procedures and considers and reports to the Board of Directors with respect to other auditing and accounting matters, including the selection of independent auditors, the scope of annual audits, fees to be paid to independent auditors and the performance of independent auditors. The Audit Committee consists of three (3) non-employee directors: Mr. Feldman, Ms. Lyle and Mr. Renton III. The members of the audit committee are "independent" as that term is used in Item 7(d)(3)(iv) of Schedule 14A of the Exchange Act and Rule 4200(a)(15) of the National Association of Securities Dealers' ("*NASD*") listing standards.

The Compensation Committee reviews and recommends to the Board of Directors certain salaries, benefits and stock option grants for employees, consultants, directors and other individuals compensated by SangStat. The Compensation Committee also administers the stock option and other employee benefit plans. In fiscal 2000, the Board of Directors approved and adopted a written charter, which sets forth the Audit Committee's duties and responsibilities and reflects Commission regulations and NASD rules. In 2002, the Compensation Committee consisted of three (3) non-employee directors: Mr. Perlman, Mr. Renton and Nicholas Simon, a director until May 15, 2003. It presently consists of two (2) non-employee directors: Mr. Perlman and Mr. Renton.

The Nominating Committee proposes a slate of directors for election by SangStat's stockholders at stockholder meetings. In performing this function, the Nominating Committee considers nominees recommended by stockholders. Such recommendations should be submitted in writing to SangStat's Secretary and should include a description of the proposed nominee's qualifications, other relevant biographical data and the written consent of the proposed nominee to serve, if elected. In addition, the Bylaws establish certain procedures concerning stockholder nominations for election of directors. The Bylaws generally require that notice of such nominations be delivered to the Secretary within the following specified time limits prior to the stockholders meeting at which the directors are to be elected: 120 days in advance of the first anniversary of the date the Proxy Statement was released to the stockholders in the previous year; and the tenth day following the date on which notice of a special meeting is first given to stockholders. Each notice of nomination is required to contain: (a) the name and address of the stockholder who intends to make the nomination and of the person or persons to be nominated; (b) a representation that the stockholder is a holder of record of stock of the Corporation entitled to vote for the election of directors on the date of such notice and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice; (c) a description of all arrangements or understandings between the stockholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by the stockholder; (d) such other information regarding each nominee proposed by such stockholder as would be required to be included in a proxy statement filed pursuant to the proxy rules of the Commission, had the nominee been nominated, or intended to be nominated, by the Board of Directors; and (e) the consent of each nominee to serve as a director of the Corporation if so elected. In 2002, the Nominating Committee consisted of three (3) non-employee directors: Mr. Feldman, Mr. Perlman and Mr. Simon. It presently consists of two (2) non-employee directors: Mr. Feldman and Mr. Perlman.

In 2002, SangStat also established a Search Committee for the replacement of the Chief Executive Officer. In October 2002, the Search Committee appointed Mr. Murdock as interim Chief Executive Officer, and on March 27, 2003, the SangStat Board of Directors removed the interim status and

appointed Mr. Murdock President and Chief Executive Officer. The members of the Search Committee were Mr. Feldman, Ms. Lyle, Mr. Perlman and Mr. Renton.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION IN COMPENSATION DECISIONS

From September 2001 to September 2002, the members of the Compensation Committee were Mr. Murdock, Mr. Simon and Mr. Worms. In September 2002, Mr. Murdock and Mr. Worms were replaced by Mr. Perlman and Mr. Renton. On May 15, 2003, Mr. Simon's term as a director ended. None of SangStat's executive officers served during fiscal year 2002 as a member of the board of directors or compensation committee of any entity that has had one or more executive officers which served as a member of the Board of Directors or Compensation Committee.

EXECUTIVE OFFICERS

In addition to Richard Murdock, who is a director, the names, ages and experience of the other executive officers of SangStat are as follows.

Steve Aselage, 51, joined SangStat in February 1999 and currently is the Senior Vice President, North American Sales and Marketing. From 1995 to December 1998, Mr. Aselage was the Director of Sales and Marketing at Advanced Tissue Sciences, a tissue engineering company. Mr. Aselage received a B.S. in biology from the University of Notre Dame.

Stephen G. Dance, 52, has been the Chief Financial Officer since December 2002. Before that, he was the Senior Vice President, Finance since joining Sangstat in April 1999. From July 1998 to April 1999, Mr. Dance was Director of Financial Accounting, Planning and Reporting at Plantronics, Inc., a telecommunications company. From 1983 to July 1998, Mr. Dance held various positions with Syntex Corporation, a pharmaceutical company, which was acquired by Roche Holding Ltd., also a pharmaceutical company, in 1994, serving most recently as Controller, Syntex Laboratories, Inc. Mr. Dance holds a B.A. in French from Leeds University in England, is a Certified Public Accountant in the State of California and a fellow of the Institute of Chartered Accountants in England and Wales.

Raymond J. Tesi, M.D., 47, joined SangStat in May 1997 and currently is the Senior Vice President, Clinical Development and Medical Affairs. From 1994 until 1997, Dr. Tesi was an associate professor of surgery and director of the extra-renal transplantation program at Tulane Medical School in New Orleans, Louisiana. He was a transplantation surgical fellow at the Ohio State University Hospital. Dr. Tesi received an M.D. from the Washington University School of Medicine in St. Louis, Missouri.

Ralph E. Levy, 54, joined SangStat in 1990 and currently is the Senior Vice President, Operations. Mr. Levy received a B.S. in chemistry from the City College of New York and an M.S. in chemistry from Seton Hall University.

Rayasam S. Prasad, 50, joined SangStat in June 2002 as the Senior Vice President, Worldwide Regulatory Affairs and Compliance. Mr. Prasad was employed by Aviron from 1999 to 2002, and in 2000 became its Senior Vice President, Technical Affairs. From 1994 to 1999, he was Head of Regulatory, Quality and Drug Safety for Chiron Vaccines. Mr. Prasad holds a B.S in Pharmacy from Andhra University, India.

Adrian Arima, 53, joined SangStat in September 2001 and currently is the Senior Vice President, General Counsel and Secretary. From 1997 until 2000, he was with the gene and cell therapy subsidiaries of Novartis AG, including SyStemix, Inc. and Genetic Therapy, Inc., rising to Vice President and General Counsel. From 1995 to 1997, he was Counsel to Gray Cary Ware & Freidenrich, a law firm in Palo Alto, California. Mr. Arima received his B.A. and M.S. from Stanford University and his J.D. from the University of California, Berkeley.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires officers, directors and persons who own more than 10% of SangStat's common stock to file reports of ownership on Form 3 and changes in ownership on Form 4 or 5 with the Commission and the Nasdaq National Market. Such officers, directors and 10% holders are also required by the Commission to furnish SangStat with copies of all Section 16(a) forms that they file.

Based solely on SangStat's review of copies of such reports received or written representations from certain reporting persons, SangStat believes that all Section 16(a) filing requirements applicable to its officers, directors and 10% stockholders were complied with during the fiscal year ended December 31, 2002, except that Dr. Tesi was late in reporting his initial ownership.

EXECUTIVE COMPENSATION

Compensation of Named Executive Officers

The following table shows information concerning the compensation paid for services rendered in all capacities to SangStat and its subsidiaries for 2000, 2001 and 2002 for Named Executive Officers. The compensation described in this table was paid by SangStat.

SUMMARY COMPENSATION TABLE

		Annual Compensation(1)			Long-Term Compensation	
Name and Principal Position	**Year**	**Salary($)**	**Bonus($)(3)**	**Other Annual Compensation(4)**	**Number of Stock Options Granted(#)**	**All Other Compensation($)(5)**
Richard D. Murdock (1) Chairman of the Board, Chief Executive Officer & President	2002	$ 82,654		$ 16,000	68,000	$ 172
Jean-Jacques Bienaimé (2)	2002	378,976	100,000	556,712	220,000	10,030
	2001	341,040	215,935		134,000	2,060
	2000	319,000	75,457		73,500	1,985
Steve Aselage	2002	$ 233,844	$ 144,588		$ 55,000	$ 8,552
Senior Vice President, North	2001	218,546	87,259		54,000	552
American Sales and Marketing	2000	181,875	44,794		41,531	285
Stephen G. Dance	2002	219,453	128,627		40,000	8,552
Chief Financial Officer	2001	198,250	64,493		45,000	552
	2000	171,667	29,107		31,216	285

					Long-Term Compensation	
Raymond J. Tesi, M.D.	2002	250,425	138,449		35,000	8,360
Senior Vice President,	2001	235,333	76,705		49,000	360
Clinical Development and	2000	196,713	42,550		36,216	285
Medical Affairs						
Robert Floc'h	2002	164,968	49,180	299,134		
General Manager,	2001	142,585	24,051	14,234		
Imtix-Sangstat	2000	145,540	17,463	11,230	5,426	

(1) Mr. Murdock was appointed Chairman, CEO and President in October 2002.

(2) Mr. Bienaimé was Chairman, CEO and President until his resignation effective November 2002. He remains a director of SangStat. Mr. Bienaimé's salary includes vacation pay in the amount of $26,178.

(3) Represents cash bonuses earned in the indicated fiscal years and retention bonuses paid to the Named Executive Officers.

(4) Mr. Bienaimé's other compensation represents loan and accrued interest forgiveness income and reimbursement for the payment of taxes attributable to the loan and interest made by SangStat, board compensation and legal fee reimbursement. Mr. Murdock's other compensation represents board compensation. Mr. Floc'h's other compensation represents severance benefits for his termination of service effective December 31, 2002, and the use of a company-provided car in 2000, 2001 and 2002.

(5) Life insurance premiums paid by SangStat and the matching contribution to the 401(k) Plan which SangStat made on behalf of the Named Executive Officers.

Grants of Options

The following table provides information related to stock options granted to the Named Executive Officers during the fiscal year ended December 31, 2002.

OPTION GRANTS IN 2002

The following table shows, with respect to the Named Executive Officers, certain information concerning the grant of stock options in 2002. No stock appreciation rights were granted during 2002.

	Individual Grants				Potential Realizable Value At Assumed Annual Rates Of Stock Price Appreciation For Option Term(3)	
Name	**Number of Securities Underlying Options Granted (1)**	**% of Total Options Granted To Employees In 2002(2)**	**Exercise Price ($/Share)**	**Expiration Date**	**5%**	**10%**
Richard D. Murdock	8,000	0.6%	21.58	05/14/12	108,572	275,144
	60,000	4.8%	17.32	10/22/12	653,547	1,656,217
Jean-Jacques Bienaimé	50,000	4.0%	17.87	01/31/12	561,917	1,424,009
	70,000	5.6%	19.38	02/20/12	853,158	2,162,071

	Individual Grants					
	100,000	8.0%	21.45	06/26/12	1,348,979	3,418,578
Steve Aselage	35,000	2.8%	19.38	02/20/12	426,579	1,081,036
	20,000	1.6%	15.00	12/04/12	188,668	478,123
Stephen G. Dance	30,000	2.4%	19.38	02/20/12	365,639	926,602
	10,000	0.8%	15.00	12/04/12	94,334	239,061
Raymond J. Tesi	35,000	2.8%	19.38	02/20/12	426,579	1,081,036

(1) Option grants were made under SangStat's 2002 Option Plan and Director's 1996 Option Plan. Each grant allows the officer to acquire shares of SangStat's Common Stock at a fixed price per share (the market price on the grant date) over a specified period of time. During the fiscal year ended December 31, 2002, Messrs. Murdock, Bienaimé, Aselage, Dance, and Dr. Tesi were granted options to purchase 60,000 shares, 220,000 shares, 55,000 shares, 40,000 shares and 35,000 shares, respectively under SangStat's 2002 Option Plan. These options have a 10-year term and twenty-five percent (25%) of the shares subject to the option vest on the first anniversary of the grant date with the remaining shares vesting in thirty-six successive equal monthly installments over the optionee's continued service with SangStat. With respect to the option to purchase 8,000 shares granted to Mr. Murdock under the 1996 Director's Plan on May 14, 2002 was an annual board option grant and subject to immediate vesting. With respect to the options granted to Mr. Bienaimé all options ceased vesting on November 15, 2002.

(2) Based on an aggregate of 1,243,050 options granted to employees and Board members in 2002, including options granted to the Named Executive Officers.

(3) The potential realizable values are based on an assumption that the price of the common stock will appreciate at the compounded annual rate shown from the date of grant until the end of the

option term. These values do not take into account amounts required to be paid as income taxes under the Internal Revenue Code and any applicable state laws or option provisions providing for termination of an option following termination of employment, non-transferability or vesting. These amounts are calculated based on the requirements promulgated by the SEC and do not reflect an estimate of future stock price growth.

AGGREGATED OPTION EXERCISES IN 2002 AND YEAR-END OPTION VALUES

The following table sets forth information concerning option exercises and option holdings for the fiscal year ended December 31, 2002 with respect to the Named Executive Officers. Except as set forth below, no options or stock appreciation rights were exercised by any such individual during such year, and no stock appreciation rights were outstanding on December 31, 2002.

			Number of Shares Underlying Unexercised Option at December 31, 2002		Value of Unexercised In-the-Money Options at December 31, 2002 (Market price of shares at 12/31/02 ($11.30) less Exercise price)	
Name	**Shares Acquired on Exercise($)**	**Value Realized (Market price at Exercise less Exercise price)($)**	**Exercisable(1)**	**Unexercisable**	**Exercisable**	**Unexercisable**
Richard D. Murdock	0	0	76,295	45,618	$ 1,661	$ 1,964
Jean-Jacques Bienaimé	12,000	130,899	324,119	87,881	21,831	30,851
Steve Aselage	10,000	143,192	58,483	112,548	10,596	33,104
Stephen G. Dance	0	0	65,640	78,076	21,686	20,027

					Value of Unexercised In-the-Money Options at December 31, 2002 (Market price of shares at 12/31/02 ($11.30) less Exercise price)	
Raymond J. Tesi	0	0	96,652	85,564	25,461	29,483
Robert Floc'h (2)	6,000	85,745	48,295	0	109,700	0

(1) The options are exercisable upon vesting and are not subject to repurchase by SangStat. Exercisable shares represent vested options at December 31, 2002.

(2) With respect to options granted to Mr. Floc'h, vesting of all outstanding options ceased as of his date of termination of employment, December 31, 2002. Certain vested options remained exercisable until March 31, 2003 and certain vested options will remain exercisable until June 30, 2004.

Agreements, Termination of Employment and Change-In-Control Arrangements for Named Executive Officers

SangStat has not entered into employment agreements with the Named Executive Officers, and their employment with SangStat may be terminated at any time at the discretion of the Board of Directors.

In December 2000, SangStat entered into individual Change in Control agreements (the "*Agreements*") with Mr. Dance, Mr. Aselage and Dr. Tesi and certain other executive officers. The Agreements are not employment contracts but are intended to ensure that SangStat will have the continued dedication and objectivity of the employee, notwithstanding the possibility or occurrence of a change of control. The Agreements provide various severance benefits to such key employees if their employment is terminated (other than for cause (as defined in the Agreements), disability or death) or an involuntary termination (as defined in the Agreements) occurs, in either case within one (1) month prior to, upon or within eighteen (18) months following a change of control. A change in control would be triggered by the occurrence of any of the following events: (i) the acquisition by any person of beneficial ownership of more than fifty percent of the total combined voting power of SangStat's outstanding voting securities, (ii) a merger or consolidation of SangStat, other than a merger or consolidation which would result in the voting securities of SangStat outstanding immediately prior

thereto continuing to represent more than fifty percent of the total combined voting securities of SangStat or any surviving entity, (iii) a complete liquidation of SangStat; or (iv) the sale or disposition by SangStat of all or substantially all SangStat's assets.

The Agreements provide for the following severance benefits to each officer: (i) a lump sum payment equal to two times base salary plus bonuses received in the previous twelve months and a pro-rated estimated bonus for the current year, (ii) accelerated vesting of any stock options, (iii) forgiveness of relocation expenses or moving expenses, if applicable, (iv) forgiveness of outstanding loans, if any, (v) continuation for two years of the health care benefits that were being provided by SangStat to such officer and his or her family immediately prior to termination, and (vi) outplacement services up to $15,000 at SangStat's expense. Each of the Agreements is substantially identical, except that the agreement with Dr. Tesi provides for (i) a lump sum payment equal to one times base salary, (ii) only one year of paid health care benefits and (iii) outplacement services capped at $10,000.

All benefits payable under the Agreements with Mr. Aselage and Dr. Tesi would be reduced to the extent necessary to preserve the ability of SangStat to deduct the severance benefits paid and to prevent payments to any officer from exceeding the limit of Section 4999 of the Code, applicable to any "excess parachute payment" (as defined in Section 280G of the Code). For Mr. Dance, the amount of such payments shall be either: (a) the full amount of the payments, or (b) a reduced amount which would result in no portion of the payments being subject to the excise tax imposed pursuant to Section 4999 of the Code, whichever of (a) or (b), taking into account the applicable federal, state and local income taxes and the Excise Tax, results in the receipt by Mr. Dance, on an after-tax basis, of the greatest amount of benefit.

In March 2003, SangStat entered into a letter agreement with its Chief Executive Officer, Richard Murdock. The agreement provides that if Mr. Murdock's employment is terminated without cause (as determined by the Board of Directors) within one month prior to or within eighteen months following a defined Change of Control, Mr. Murdock will be entitled to a severance payment of two years' base salary plus an amount equal to bonuses received in the previous twelve months. In addition, if Mr. Murdock is terminated under circumstances entitling him to severance, 50% of his unvested stock options will immediately accelerate and become exercisable. For purposes of Mr. Murdock's agreement, a Change of Control would be triggered by the occurrence of any of the following events: (i) the acquisition by any person of beneficial ownership of more than fifty percent of the total combined voting power of SangStat's outstanding voting securities, (ii) a merger or consolidation of SangStat, other than a merger or consolidation which would result in the voting securities of SangStat outstanding immediately prior thereto continuing to represent more than fifty percent of the total combined voting securities of SangStat or any surviving entity, (iii) a complete liquidation of SangStat, or (iv) the sale or disposition by SangStat of all or substantially all SangStat's assets. The agreement does not provide a term of employment and Mr. Murdock's employment with SangStat is on an at-will basis.

In October 2002, SangStat entered into a Separation Agreement with Mr. Bienaimé. The Agreement provided for the payment of the following amounts: (i) $100,000, representing the pro rata portion of his discretionary bonus for 2002, paid upon his separation date in November 2002 (the "*Separation Date*"), (ii) a final tax gross up payment of $65,000 paid on the Separation Date in full satisfaction of SangStat's prior commitment (see "Officer Loans" below), (iii) the cash compensation customarily paid to the non-employee members of the Board of Directors, including the annual retainer payment of $15,000 for 2002, and (iv) reimbursement of legal expenses not exceeding $5,000. In addition, certain time-based stock options to purchase up to a maximum of an additional 75,963 shares of common stock (the "*Time-Based Options*") will continue to vest in accordance with and subject to their existing terms and conditions until May 17, 2004, provided that Mr. Bienaimé remains on the Board of Directors until such date, and all remaining Time-Based Options to purchase the then-remaining unvested shares will be cancelled as of May 17, 2004. Options vested as of the Separation

Date or by May 17, 2004, as the case may be, will remain exercisable in accordance with and subject to their existing terms and conditions and, if unexercised, shall expire within enumerated periods set forth in the respective option agreements or plan following termination of Mr. Bienaimé's service on the Board. In addition, in the event of a Change of Control or the consummation of a Corporate Transaction (as defined in SangStat's 2002 Stock Option Plan) prior to May 17, 2004, the vesting of all of the Time Based Options, if any, that remain unvested as of the date of such event will immediately be accelerated without further action by SangStat, provided that Mr. Bienaimé remains on the Board of Directors until such date.

On December 31, 2002, Robert Floc'h's employment as the General Manager of SangStat's IMTIX-SangStat SAS subsidiary in France terminated. SangStat provided separation benefits to Mr. Floc'h valued at 281,271 Euros. This amount included the transfer to Mr. Floc'h of a Company-provided automobile that had a value of 15,104 Euros and personal computers valued at 1,500 Euros. SangStat extended the time for Mr. Floc'h to exercise certain vested stock options to eighteen months after his termination date. These stock options were for 29,295 shares of SangStat's common stock, and all of these options had an exercise price that was greater than the market value of the underlying shares as of the date of his termination.

See Item 3. "Past Contacts, Transactions, Negotiations and Agreements" for a discussion of change of control agreements with the officers of SangStat.

Officer Loans

SangStat extended loans to Mr. Bienaimé, a director and executive officer, to provide housing assistance as part of his relocation package. SangStat made Mr. Bienaimé's loans in July 1998 ($200,000) and in September 2000 ($100,000). Mr. Bienaimé's $200,000 loan was evidenced by a promissory note secured by options to purchase shares of SangStat's Common Stock and his loan for $100,000 was secured by a deed of trust on his property. The annual interest rate on the loans was 5.69%. Mr. Bienaimé has not repaid any principal amounts or interest due on his loans, which were originally due on July 17, 2001 and September 12, 2001. On February 1, 2001, SangStat entered into a retention agreement with Mr. Bienaimé, under which SangStat would forgive his outstanding loans, including any accrued interest thereon, if Mr. Bienaimé was Chief Executive Officer of SangStat as of September 30, 2001. SangStat subsequently amended its retention agreement with Mr. Bienaimé by extending from September 30, 2001 to January 31, 2002 the date on which SangStat would forgive Mr. Bienaimé's loans. In exchange, SangStat agreed to pay him an amount equal to the federal and state income taxes arising from the forgiven loans over the three ensuing quarters, subject to his continued employment as Chief Executive Officer of SangStat. On January 31, 2002, SangStat forgave all outstanding loans made to Mr. Bienaimé, which amounted to $351,157 in principal amount and accrued interest as of such date. SangStat also paid $184,555 to Mr. Bienaimé as compensation for the federal and state income taxes on the amount forgiven.

SangStat extended a loan to Dr. Tesi, an executive officer, in September 1997 in the amount of $200,000 at an interest rate of 6.0% to provide housing assistance as part of his relocation package. Dr. Tesi has not repaid any principal amounts or interest due on his loan, which were originally due on October 1, 2001. His loan was evidenced by a promissory note secured by options to purchase shares of SangStat's Common Stock. On February 20, 2002, the Compensation Committee adopted an amended schedule for the forgiveness of Dr. Tesi's loan, under which SangStat will forgive approximately one-third of Dr. Tesi's loan and the accrued interest thereon in each of three annual installments beginning on January 7, 2003 and ending on January 7, 2005, provided that Dr. Tesi remains continuously employed with SangStat through the installment dates for the respective installments to be forgiven. At December 31, 2002, the aggregate indebtedness of Dr. Tesi under the loan was $272,485, including a principal amount of $200,000 and accrued interest of $72,485. On January 7, 2003, SangStat forgave principal in the amount of $68,000 and interest in the amount of $24,735. The amount owed by

Dr. Tesi under his loan in principal amount and accrued interest as of February 28, 2003 was $181,553. In accordance with Dr. Tesi's Change in Control Agreement, the principal and interest under his loan will be forgiven if his employment is terminated (other than for cause (as defined in the Agreement), disability or death) or an involuntary termination (as defined in the Agreement) occurs, in either case within one (1) month prior to, upon or within eighteen (18) months following a change of control.

Transactions With Related Parties

The following is a summary of significant transactions and relationships among SangStat and its directors, executive officers and significant stockholders with respect to fiscal year 2002.

Since January 1, 2002, there has not been, nor is there currently proposed, any transaction or series of similar transactions to which SangStat was or is to be a party in which the amount involved exceeds $60,000 and in which any director, executive officer or holder of more than 5% of common stock, or an immediate family member of any of the foregoing, had or will have a direct or indirect interest other than:

compensation arrangements, which are described above; and

the transactions described below.

SangStat entered into agreements with Therapeutic Human Polyclonals, Inc. ("*THP*"), a private biotechnology company. Roland Buelow, an executive officer of SangStat during 2002, is a founder of THP and owns a substantial portion of the common stock of THP. The agreements include options to obtain exclusive licenses to the THP technology to produce humanized polyclonal antibody products. One option is for a humanized version of SangStat's current Thymoglobulin product. SangStat also has options to obtain exclusive licenses to products to treat hematology (blood related) diseases, such as leukemia and lymphoma. The options have an exercise period that commences when THP has produced a genetically engineered rabbit capable of producing commercial-grade humanized antibodies. Each license would have an up-front fee, milestone payments based on progression through clinical trials to product approval, and royalties. THP has the right to contribute to the development costs for hematology products and receive a commensurate share of profits from commercial sales. SangStat shares antibody purification know-how with THP. In November 2002, SangStat made a one-time technology access fee payment to THP of $500,000 under the terms of the agreement.

Additionally, SangStat made an equity investment of $3.2 million in THP and is committed to make a second investment of $3.2 million when THP has produced the proof-of-principle engineered rabbit, unless that milestone is unduly delayed. The total of these investments would represent ownership of approximately twenty percent (20%) of the issued share capital of THP. SangStat's investments are made in conjunction with investments by Research Corporation Technologies, Inc., which provided start-up financing for THP and is the majority shareholder of THP. When THP has produced the commercial-grade engineered rabbit, SangStat has an option to make an additional equity investment of $15.0 million, which would give SangStat ownership of approximately 40% of THP's issued share capital. SangStat does not have the right to acquire full ownership of THP.

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

This section is not "soliciting material," is not deemed "filed" with the Commission by including this information in this Statement, and is not incorporated by reference into any of SangStat's filings under the 1933 Act or the 1934 Act, whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing.

SangStat's executive compensation program presently is administered by the two-member Compensation Committee of the Board of Directors as set forth below.

The objectives of SangStat's executive compensation policies are to attract, retain and reward executive officers who contribute to SangStat's success, to align the financial interests of executive officers with SangStat's performance, to strengthen the relationship between executive pay and stockholder value, to motivate executive officers to achieve SangStat's business objectives and to reward individual performance. SangStat's executive compensation package consists of three (3) components: base salary and related benefits; annual quarterly cash bonus incentives; and equity-based compensation incentives.

The first component of SangStat's executive compensation package is base salary and related benefits. Each executive officer receives a base salary and benefits based on competitive compensation information and his responsibilities and performance. The second component of SangStat's executive compensation package is an annual management-by-objectives bonus. Each year, SangStat establishes bonus compensation formulas for each such officer based on certain individual and Company performance criteria and Company key objectives. This arrangement provides each executive officer with the opportunity to earn a cash bonus according to the extent to which he meets his particular individual performance criteria. The third component of SangStat's executive compensation package is stock options, which SangStat believes is an important incentive tool designed to more closely align the interests of SangStat's executive officers with the long-term interests of SangStat's stockholders and to encourage SangStat's executive officers to remain with SangStat. Generally, SangStat grants stock options at fair market exercise prices, as determined at the time of grant.

SangStat's stock option plans have been established to provide all employees with an opportunity to share, along with stockholders, in SangStat's long-term performance. Periodic grants of stock options are generally made annually to eligible employees, with additional grants being made to certain employees upon commencement of employment and, occasionally, following a significant change in job responsibilities, scope or title. Stock options granted under the plans generally have a non-statutory four-year vesting schedule and generally expire ten years from the date of grant. In addition, a portion of the options granted to SangStat's executive officers are performance-based options. The Compensation Committee periodically considers the grant of stock-based compensation to all executive officers. Such grants are made on the basis of a quantitative and qualitative analysis of individual performance, SangStat's financial performance, and the executive's existing options.

The bonuses and salaries for Messrs. Murdock and Bienaimé during 2002 were set by the Committee with due regard to their industry experience, competitive salary information and current market conditions. The amount of Mr. Murdock's total compensation was based on negotiations with him prior to his commencement of employment. Mr. Bienaimé's annual bonus was paid in accordance with his Separation Agreement.

Section 162(m) of the Internal Revenue Code of 1986, as amended, generally provides that publicly held companies may not deduct compensation paid to certain of its top executive officers to the extent such compensation exceeds $1 million per officer in any year. However, pursuant to regulations issued by the Treasury Department, certain limited exceptions to Section 162(m) apply with respect to "performance-based compensation." Awards granted under the 2002 Stock Option Plan are intended to constitute qualified performance-based compensation eligible for such exceptions, and SangStat will continue to monitor the applicability of Section 162(m) to SangStat's ongoing compensation arrangements. SangStat does not expect that amounts of compensation paid to SangStat's executive officers will fail to be deductible on account of Section 162(m).

Compensation Committee

Andrew J. Perlman (Chair)
Hollings C. Renton III

REPORT OF THE AUDIT COMMITTEE
OF THE BOARD OF DIRECTORS

This section is not "soliciting material," is not deemed "filed" with the Commission by including this information in this Statement, and is not incorporated by reference into any of SangStat's filings under the 1933 Act or the 1934 Act, whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing.

The Audit Committee is comprised of three (3) outside directors, all of whom are independent under Rule 4200(a)(14) of the NASD listing standards. In fiscal 2000, the Board of Directors approved and adopted a written charter, which sets forth the Audit Committee's duties and responsibilities and reflects new Commission regulations and NASD rules.

The Audit Committee has reviewed and discussed our audited financial statements for the fiscal year ended 2002 with management and without our independent auditors, Deloitte & Touche LLP. The Audit Committee has discussed with Deloitte & Touche LLP the matters required to be discussed by Statement on Auditing Standards No. 61 relating to the conduct of the audit. The Audit Committee has received the written disclosures and the letter from Deloitte & Touche LLP required by Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees, and has discussed with Deloitte & Touche LLP their independence. The Audit Committee has considered the compatibility of the provision of non-audit services with maintaining the auditor's independence.

Based on the Audit Committee's review of the audited financial statements and the review and discussion described in the foregoing paragraph, the Audit Committee recommended to the Board of Directors that the audited financial statements for the fiscal year ended December 31, 2002 be included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2002 for filing with the SEC.

Audit Committee

Corinne H. Lyle (Chair)
Fredric J. Feldman
Hollings C. Renton III

PERFORMANCE GRAPH

This section is not "soliciting material," is not deemed "filed" with the Commission by including this information in this Statement, and is not incorporated by reference into any of SangStat's filings under the 1933 Act or the 1934 Act, whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing.

Set forth below is a graph comparing the percentage change in SangStat's cumulative total stockholder return on its common stock from December 31, 1997 to December 31, 2002 (as measured by dividing (i) the excess of the price of SangStat's common stock at the end of the measurement period over the price at the beginning of the measurement period by (ii) the share price at the beginning of the measurement period) with the cumulative total return so calculated of the Nasdaq Biotech Index, the S&P 500 Index and the BioTech Index (BTK). The historical stock price performance is not necessarily indicative of future results.

QuickLinks

9pt; color: #000000; font-weight: bold; font-style: normal;background-color: #ffffff;">2006 Cash Flows From Operating Activities Net income (loss) $ (30,545) $ 152,710 Adjustments to reconcile net income (loss) to net cash used in operating activities Depreciation and amortization 6,423 4,902 Other amortization and accretion 1,876 4,211 (Earnings) losses from equity method investees 23,289 (3,412) Distributions of earnings from equity method investees 9,765 7,057 (Gains) losses from investments 727,971 (2,776,627) Deferred incentive income (355,381) 475,655 Principals' and others' interests in income (loss) of consolidated subsidiaries (854,550) 2,403,346 Deferred tax expense (16,775) 751 Options received from affiliates (2,006) (18,692) Assignments of options to employees 4,627 7,577 Equity-based compensation 713,850 — Cash flows due to changes in Cash held at consolidated subsidiaries and restricted cash (166,199) (285,058) Due from affiliates 562,731 (160,906) Receivables from brokers and counterparties and other assets (23,024) (28,070) Due to affiliates (6,392) (45,795) Accrued compensation and benefits 48,174 71,194 Due to brokers and counterparties and other liabilities 118,098 (34,844) Investment company holdings Purchases of investments (5,105,865) (10,223,969) Proceeds from sale of investments 3,398,739 6,992,398 Net cash used in operating activities (945,194) (3,457,572) Cash Flows From Investing Activities Purchase of other loan and security investments (10,578) (351,852) Proceeds from sale of other loan and security investments 317 320,644 Contributions to equity method investees (560,272) (828) Proceeds from sale of equity method investments 29,071 — Distributions of capital from equity method investees 115,190 572 Cash received on settlement of derivatives 132 (454) Purchase of fixed assets (8,907) (10,814) Proceeds from disposal of fixed assets 2,532 — Net cash used in investing activities (432,515) (42,732) Cash Flows From Financing Activities Borrowings under debt obligations 1,999,070 3,901,047 Repayments of debt obligations (2,010,025) (3,034,196) Payment of deferred financing costs (6,813) (27,487) Issuance of Class A shares to Nomura 888,000 — Issuance of Class A shares in initial public offering 729,435 — Costs related to initial public offering (76,766) — Dividends and dividend equivalents paid (43,237) — Fortress Operating Group capital distributions to Principals (415,876) (350,106) Purchase of Fortress Operating Group units from Principals (888,000) — Principals' and others' interests in equity of consolidated subsidiaries – contributions 3,249,847 4,078,527 Principals' and others' interests in equity of consolidated subsidiaries – distributions (1,939,554) (1,072,117) Net cash provided by financing activities 1,486,081 3,495,668 Net Increase (Decrease) in Cash and Cash Equivalents 108,372 (4,636) Cash and Cash Equivalents, Beginning of Period 61,120 36,229

Cash and Cash Equivalents, End of Period $ 169,492 $ 31,593 Supplemental Disclosure of Cash Flow Information Cash paid during the period for interest (excluding interest paid by master funds while such funds were consolidated of $85.1 million and $257.9 million, respectively) $ 70,003 $ 121,717 Cash paid during the period for income taxes $ 30,158 $ 1,912 Supplemental Schedule of Non-cash Investing and Financing Activities Investment of amounts payable to employees into Fortress Funds $ 15,102 $ 24,019 Dividends, dividend equivalents and Fortress Operating Group unit distributions declared but not yet paid $ 43,009 $ — See Note 1 regarding the non-cash deconsolidation transaction

See notes to consolidated and combined financial statements

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

1. ORGANIZATION AND BASIS OF PRESENTATION

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

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

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

The accompanying consolidated financial statements include the following:

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

Reorganization of Fortress Operating Group

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

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FORTRESS INVESTMENT GROUP LLC
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NOTES TO CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS (Unaudited)
SEPTEMBER 30, 2007
(dollars in tables in thousands, except share data)

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

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

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

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

Nomura Transaction

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

Initial Public Offering (''IPO'')

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

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

$652.7 million. The Registrant contributed the net proceeds from the offering to Fortress Operating Group in exchange for 39,428,900 Fortress Operating Group units. As of September 30, 2007, Fortress Operating Group had applied those proceeds in accordance with its IPO registration statement as follows: (a) to pay $250 million then outstanding under its term loan facility, as required by the credit agreement (Note 4), (b) to pay $85 million then outstanding under its revolving credit facility (Note 4), (c) to fund $169 million of commitments to private equity funds, and (d) to fund $149 million of general business purposes, including additional investments.

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

Consolidation and Deconsolidation of Fortress Funds

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

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

The accompanying consolidated financial statements and related notes of Fortress have been prepared in accordance with accounting principles generally accepted in the United States for interim financial reporting and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared under U.S. generally accepted accounting principles have been condensed or omitted. In the opinion of management, all adjustments considered necessary for a fair presentation of Fortress's financial position, results of operations and cash flows have been included and are of a normal and recurring nature. The operating results presented for interim periods are not necessarily indicative of the results that may be expected for any other interim period or for the entire year. These financial statements should be read in conjunction with Fortress's combined financial statements for the year ended December 31, 2006 and notes thereto included in Fortress's annual report on Form 10-K filed with the

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Securities and Exchange Commission. Capitalized terms used herein, and not otherwise defined, are defined in Fortress’s combined financial statements for the year ended December 31, 2006.

2. MANAGEMENT AGREEMENTS AND FORTRESS FUNDS

Management Fees, Incentive Income and Related Profit Sharing Expense

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

		Nine Months Ended September 30, 2007
Private Equity Funds	Management fees	$ 97,358
	Incentive income	317,574
Liquid Hedge Funds	Management fees	112,381
	Incentive income	157,559
Hybrid Hedge Funds	Management fees	93,032
	Incentive income	1,832
Castles	Management fees	35,251
	Management fees-options	2,006
	Incentive income	18,596
Total	Management fees	$ 340,028
	Incentive income	$ 495,561

Incentive Income Subject to Annual Performance Criteria

Incentive income from certain Fortress Funds is earned based on achieving annual performance criteria. Accordingly, this incentive income is recorded as revenue at year end (in the fourth quarter of each year) and has not been recognized for these funds during the nine months ended September 30, 2007 and 2006. If the amount of incentive income contingent on achieving annual performance criteria was not contingent on the results of the subsequent quarters, $92.0 million and $85.6 million of additional incentive income from affiliates would have been recognized during the nine months ended September 30, 2007 and 2006, respectively. These amounts are included as ‘‘undistributed’’ deferred incentive income in the table below.

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

	September 30, 2007	December 31, 2006
Distributed-gross	$ 444,722	$ 252,774
Less: Recognized (A)	(267,272)	(9,473)
Distributed-unrecognized	$ 177,450	243,301
Undistributed (B)	688,436	1,405,481
Total	$ 865,886	$ 1,648,782

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

As of September 30, 2007, from inception to date, Fortress has recognized and paid compensation expense under its employee profit sharing arrangements in connection with the $444.7 million of distributed incentive income. If the $688.4 million of undistributed incentive income were realized, Fortress would recognize an additional $213.3 million of compensation expense.

The change in deferred incentive income is summarized as follows:

	Distributed	Undistributed	Total
Deferred incentive income as of December 31, 2006	$ 243,301	$ 1,405,481	$ 1,648,782
Share of income (loss) of Fortress Funds	243,424	(717,045)	(473,621)
Recognition of previously deferred incentive income	(309,275)	—	(309,275)
Deferred incentive income as of September 30, 2007	$ 177,450	$ 688,436	$ 865,886

Recognized profit sharing compensation expense is summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Private equity funds	$ 1,556	$ 220	$ 94,001	$ 34,626
Liquid hedge funds	1,629	11,337	89,075	54,391
Hybrid hedge funds	5,517	18,903	43,763	44,839
Castles	1,155	1,391	8,029	6,752
Total	$ 9,857	$ 31,851	$ 234,868	$ 140,608

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Principals’ and Others’ Interests in Consolidated Subsidiaries

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

Employee interests in majority owned and controlled fund advisor and general partner entities	$ 76,369
Principals’ Fortress Operating Group units	261,883
Other	135
Total	$ 338,387

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

	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007	
	Actual	Actual	Pro Forma (A)
Employee interests in majority owned and controlled fund advisor and general partner entities	$ 2,359	$ 8,359	$ 8,359
Third party investors in Fortress Funds	—	(460,615)	—
Principals’ Fortress Operating Group units	(154,893)	(402,294)	(402,294)
Total	$ (152,534)	$ (854,550)	$ (393,935)

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

Private Equity Funds

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

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

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

In May 2007, Fortress formed a new private equity Fortress Fund known as Fortress Investment Fund V (‘‘Fund V’’) with total capital commitments from third-party investors of $4.0 billion. Fortress has committed to contribute to Fund

V an amount equal to 1.5% of Fund V's total equity contributed by third party investors, or $60 million. In June 2007, Fortress formed two additional private equity funds for the purpose of co-investing alongside Fund V in either single or multiple transactions. In total, $2.0 billion was committed by investors to these two additional funds, of which $0.4 billion was committed by Fortress and its employees. Fortress has entered into management

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

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

Liquid Hedge Funds and Hybrid Hedge Funds

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

In February 2007, one of the then consolidated hybrid hedge funds raised $1.2 billion of capital commitments from existing and new limited partners, of which 18% was called in the first quarter of 2007, 20% was called in the second quarter of 2007, and 12% was called in the third quarter of 2007. During the capital commitment period, which expires on the earlier of when it is fully drawn or December 31, 2008, no other new third party investors will be permitted in this fund.

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

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

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3. INVESTMENTS IN EQUITY METHOD INVESTEES AND OTHER EQUITY INVESTMENTS

Investments in Equity Method Investees

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

	Equity Held by Fortress		Fortress's Equity in Net Income (Loss)			
			Nine Months Ended September 30,		Three Months Ended September 30,	
	September 30, 2007	December 31, 2006	2007	2006	2007	2006
Private equity funds, excluding NIH (A)	$ 512,951	$ (A)	$ (41,682)	$ (A)	$ (33,658)	$ (A)
NIH	6,330	8,213	2,995	1,256	4,019	462
Total private equity funds	519,281	8,213	(38,687)	1,256	(29,639)	462
Liquid hedge funds (A)	84,555	(A)	192	(A)	(3,801)	(A)
Hybrid hedge funds (A)	368,956	(A)	12,984	(A)	1,649	(A)
Newcastle	4,655	13,756	777	2,029	(412)	693
Eurocastle	11,271	11,844	1,398	(84)	1,487	(288)
Other	1,723	3,437	47	211	—	125
	$ 990,441	$ 37,250	$ (23,289)	$ 3,412	$ (30,716)	$ 992

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

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

Nine Months Ended September 30, 2007	Private Equity Funds		Liquid Hedge Funds	Hybrid Hedge Funds	Castles			Total
	NIH	Other			Newcastle	Eurocastle	Other	
Investment, beginning	$ 8,213	$ —	$ —	$ —	$ 13,756	$ 11,844	$ 3,437	$ 37,250
Earnings from equity method investees	2,995	(41,682)	192	12,984	777	1,398	47	(23,289)
Other comprehensive income from equity method investees	(360)	—	—	—	(7,693)	(1,246)	—	(9,299)
Contributions to equity method investees	—	284,431	150,905	95,793	—	—	29,143	560,272
Distributions of earnings from equity method investees	(4,518)	—	(1,849)	(889)	(1,640)	(822)	(47)	(9,765)
Distributions of capital from equity method investees	—	(340)	(96,673)	(14,685)	(545)	(796)	(2,151)	(115,190)
Total distributions from equity method investees	(4,518)	(340)	(98,522)	(15,574)	(2,185)	(1,618)	(2,198)	(124,955)
Translation adjustment	—	—	—	—	—	893	—	893
Sale of investments	—	—	—	—	—	—	(28,706)	(28,706)
Deconsolidation	—	270,542	31,980	275,753	—	—	—	578,275
Investment, ending	$ 6,330	$ 512,951	$ 84,555	$ 368,956	$ 4,655	$ 11,271	$ 1,723	$ 990,441
Ending balance of undistributed earnings	$ 4,056	$ —	$ —	$ 12,095	$ —	$ 576	$ —	$ 16,727

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

	Private Equity Funds excluding NIH	Newcastle Investment Holdings LLC ("NIH")	
	September 30, 2007	September 30, 2007	December 31, 2006
Assets	$ 16,442,688	$ 351,928	$ 457,436
Liabilities	(2,286,589)	(224,824)	(315,732)
Equity	$ 14,156,099	$ 127,104	$ 141,704
Equity held by Fortress	$ 512,951	$ 6,330	$ 8,213
Ownership (A)	3.6 %	4.8 %	4.8 %

	Nine Months Ended September 30, 2007	Six Months Ended September 30, 2007	2006
Revenues and gains (losses) on investments	$ (3,329,819)	$ 93,918	$ 51,202
Expenses	(194,551)	(22,962)	(25,051)
Net Income (Loss)	$ (3,524,370)	$ 70,956	$ 26,151
Fortress’s equity in net income (loss)	$ (41,682)	$ 2,995	$ 1,256 (B)

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	Liquid Hedge Funds	Hybrid Hedge Funds
	September 30, 2007	September 30, 2007
Assets	$ 7,781,999	$ 10,674,936
Liabilities	(93,348)	(3,290,353)
Equity	$ 7,688,651	$ 7,384,583
Equity held by Fortress	$ 84,555	$ 368,956
Ownership (A)	1.1 %	5.0 %

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2007
Revenues and gains (losses) on investments	$ 1,092,573	$ 720,455
Expenses	(710,854)	(255,716)
Net Income	$ 381,719	$ 464,739
Fortress's equity in net income	$ 192 (B)	$ 12,984 (B)

(A) Excludes ownership interests held by other Fortress Funds, the Principals, employees and other affiliates.
(B) The revenues and expenses of these entities were consolidated through March 31, 2007, the effective date of the deconsolidation (Note 1). As a result, the amounts shown for Fortress's equity in net income of these entities relate to the period subsequent to March 31, 2007.

	Newcastle Investment Corp.		Eurocastle Investment Ltd.	
	September 30, 2007	December 31, 2006	September 30, 2007	December 31, 2006
Assets	$ 8,505,473	$ 8,604,392	$ 10,997,553	$ 7,295,320
Liabilities	(7,684,852)	(7,602,412)	(9,078,267)	(5,427,716)
Minority interest	—	—	(8)	(8)
Equity	$ 820,621	$ 1,001,980	$ 1,919,278	$ 1,867,596
Equity held by Fortress	$ 4,655	$ 13,756	$ 11,271	$ 11,844
Ownership, basic (A)	1.9 %	2.2 %	1.6 %	1.6 %
Ownership, diluted (A) (B)	4.5 %	4.8 %	10.0 %	10.4 %
Ownership by Fortress and affiliates, diluted (B)	15.0 %	12.3 %	29.5 %	26.6 %
Market value of shares owned (A) (C)	$ 18,073	$ 32,126	$ 34,799	$ 51,203

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	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Revenues	$ 543,369	$ 401,245	$ 552,586	$ 232,269
Expenses	(505,960)	(307,481)	(542,100)	(225,532)
Net gain on sale of investment property	—	—	65,846	—
Discontinued operations	(2)	212	—	—
Preferred dividends	(9,265)	(6,985)	—	—
Net Income	$ 28,142	$ 86,991	$ 76,332	$ 6,737
Fortress's equity in net income (loss)	$ 777	$ 2,029	$ 1,398	$ (84)

(A) Excludes shares owned by other Fortress Funds, the Principals, employees and other affiliates. (B) Fully diluted ownership represents the percentage of outstanding common shares owned assuming that all options are exercised. (C) Based on the closing price of the related shares and, if applicable, the foreign currency exchange rate on the last day of trading in the applicable period.

Options in Affiliates

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

	September 30, 2007	December 31, 2006	Accounting Treatment
Newcastle options	$ 201	$ 2,950	Held at cost subject to impairment
Eurocastle options	48,150	136,316	Qualify as a derivative, held at fair value
	$ 48,351	$ 139,266	

The fair value of the Newcastle options as of September 30, 2007 was approximately $0.2 million. The Newcastle options were written down to fair value from their cost basis of $3.6 million at September 30, 2007 due to impairment resulting from an other-than-temporary decrease in Newcastle's common share price.

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

During the nine months ended September 30, 2007, Fortress assigned a total of 320,099 Eurocastle options, with a weighted average strike price of €19.23 per share, to certain of its employees. Fortress recorded compensation expense of $3.3 million associated with the assignment of these options during the nine months ended September 30, 2007.

In April 2007, in connection with a capital raise, Newcastle issued 456,000 options to purchase shares of its common stock at $27.75 per share to Fortress, which were valued at $1.2 million. Fortress

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assigned 162,450 of these options to employees and recorded compensation expense of $0.4 million. The Principals in their personal capacities purchased approximately $60 million in the aggregate of the shares sold in this offering directly from the underwriter at the public offering price.

Investments in Variable Interest Entities

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

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

Fortress is not Primary Beneficiary Business Segment	Gross Assets	Fortress Investment (A)
Liquid Hedge Funds	$ 6,891,005	$ 47,355
Hybrid Hedge Funds	$ 502,678	$ 511

(A) Includes $0.3 million of incentive income receivable. Also represents Fortress's maximum exposure to loss with respect to these entities.

Investments in Marketable Equity Securities

As of September 30, 2007, Fortress has investments in marketable equity securities, treated as available for sale, as shown in the following table. All of these securities were purchased subsequent to June 30, 2007.

Industry	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses Less Than 12 months (A)	Gross Unrealized Losses Greater Than 12 months (A)	Fair Value/ Carrying Value	Range of

Ownership Interests	Information Services	$ 10,578	$ 749	$ —	$ —	$ 11,327	0.2 %

(A)

Determined by whether a particular security has continuously been in an unrealized loss position for greater than twelve months.

Securities available for sale are carried at market value with net unrealized gains or losses reported as a separate component of accumulated other comprehensive income. At disposition, the net realized gain or loss is determined on the basis of the cost of the specific investments and is included in earnings. Unrealized losses on securities are charged to earnings if they reflect a decline in value that is other than temporary. A decline in value is considered other than temporary if Fortress does not have the intent and ability to hold such investment until a forecasted market price recovery.

Fortress reviews its marketable equity securities on a regular basis to determine whether any security has experienced an other than temporary decline in value. Fortress considers the investee company’s current earnings, earnings outlook, credit ratings, liquidity, stock price performance and volatility, and industry and general economic factors, among other factors, as well as the severity and duration of the decline in value, in its review. To date, no such determinations of impairment have been made.

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4. DEBT AND DERIVATIVE OBLIGATIONS

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

		Face Amount and Carrying Value				As of June 30, 2007		
Debt Obligation/Collateral	Month Issued	September 30, 2007	December 31, 2006	Contractual Interest Rate	Final Stated Maturity	Weighted Average Funding Cost (D)	Weighted Average Maturity (Years)	Collateral Carrying Value
Credit agreement								
Revolving debt (A)	May 2007	$ 75,000	$ 85,000	LIBOR + 1.20% (B)	May 2012	9.49 %	4.61	(C)
Term loan	May 2007	350,000	600,000	LIBOR + 1.20%	May 2012	7.20 %	4.61	(C)
Delayed term loan (A)	May 2007	—	—	LIBOR + 1.20% (B)	May 2012	0.00 %	—	(C)
Aircraft loan	Jun 2002	—	2,153	LIBOR + 2.25%	Repaid	0.00 %	—	N/A
Total		$ 425,000	687,153			7.60 %	4.61	
Consolidated Fortress Fund debt			2,619,456					
Total			$ 3,306,609					

(A) Approximately $114.5 million and $450 million were undrawn and available on the revolving debt and delayed term loan, respectively, as of September 30, 2007, including a $25 million letter of credit subfacility of which $10.5 million was utilized. The delayed term loan must be drawn by February 2008 or its availability expires. (B) Subject to unused commitment fees of 0.375% per annum. (C) Collateralized by substantially all of Fortress Operating Group's assets as well as Fortress Operating Group's rights to fees from the Fortress Funds and its equity interest therein. (D) Includes amortzation of deferred financing costs.

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

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

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

	Notional Amount September 30, 2007	Fair Value September 30, 2007	Fair Value December 31, 2006	Longest Maturity September 30, 2007
Interest rate swaps, treated as hedges	$ —	$ —	$ 8	N/A
Foreign currency derivatives, treated as hedges	€ 8,169	(1,158)	(435)	Oct 30, 2007
Foreign currency derivatives, non-hedges	€ 28,031	(3,974)	(1,184)	Oct 30, 2007
Consolidated Fortress Fund derivatives, net		—	(38,018)	
Total		$ (5,132)	$ (39,629)	

5. INCOME TAXES AND TAX RELATED PAYMENTS

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

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

As a result of the contribution of $578.3 million of the net proceeds of the initial public offering by FIG Corp. to the capital of Fortress Operating Group, a temporary difference arose between the carrying value of Fortress Operating

Group for financial reporting purposes and that for income tax purposes. A gross deferred tax asset of $24.6 million has been recorded to reflect the deferred tax effects of the tax basis over financial reporting basis.

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

	September 30, 2007	December 31, 2006
Deferred tax assets	$ 489,801	$ 2,808
Deferred tax liabilities (A)	$ 3,143	$ 12,989

(A) Included in Other Liabilities.

For the period January 17, 2007, the reorganization date, through September 30, 2007, an estimated annual (January 17, 2007 through December 31, 2007) negative effective tax rate of (5.18%) was used to compute the tax provision on the Registrant's income subject to U.S. federal, state and local income taxes. Fortress incurred a loss before income taxes for financial reporting purposes, in this period, after deducting the compensation expense arising from the Principals' forfeiture agreement (Note 7). However, this compensation expense is not deductible for income tax purposes. Also, after the reorganization, a portion of Fortress's income is not subject to U.S. federal corporate income tax but is allocated directly to Fortress's shareholders.

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

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

Tax Receivable Agreement

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

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Although the tax receivable agreement payments are calculated based on annual tax savings, for the period ended September 30, 2007 the payments which would have been made pursuant to the tax receivable agreement, if such period was calculated by itself, were $11.3 million.

Recently Adopted Accounting Pronouncement

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

6. RELATED PARTY TRANSACTIONS

	Management Fees and Incentive Income		Dividends and Distributions		Total Due from Affiliates	
	September 30, 2007	December 31, 2006	September 30, 2007	December 31, 2006	September 30, 2007	December 31, 2006
Private equity funds	$ 1,971	$ —	$ —	$ 26,315	$ 1,971	$ 26,315
Castles	26,278	47,832	739	1,297	27,017	49,129
Liquid and hybrid hedge funds	3,850	500,889	—	—	3,850	500,889
Unconsolidated subsidiaries of liquid hedge fund subsidiaries	—	—	—	19,309	—	19,309
Subtotal	$ 32,099	$ 548,721	$ 739	$ 46,921	32,838	595,642
Other					7,034	40,106
Total					$ 39,872	$ 635,748

	Due to Affiliates	
	September 30, 2007	December 31, 2006
Private equity funds – Payments on behalf of Fortress Funds	$ —	$ 14,123
Principals – Tax receivable agreement – Note 5	390,383	—
Principals – Distributions payable on Fortress Operating Group units	16,616	—
Other	2,653	989
	$ 409,652	$ 15,112

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

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During 2007, two departing Fortress employees entered into sourcing agreements with a Fortress Fund pursuant to which the Fortress Fund agreed to make contingent payments to the former employees based on the employees sourcing future transactions for that Fortress Fund.

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

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

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

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

In September 2007, three of the Principals made an aggregate €24.6 million ($33.5 million) loan to a subsidiary of one of the private equity Fortress Funds. The Principals assigned their right to receive interest on this loan to the fund. In October 2007, this fund conducted a rights offering in which it raised €150 million ($214.0 million) of equity in a private placement to investors in the fund, of which Fortress acquired €37.9 million ($54.1 million). The proceeds from this offering were used to pay down existing fund level debt, including the loan from the Principals. In October and November 2007, these Principals invested an aggregate of €34.9 million ($50.7 million) in preferred equity interests of subsidiaries of certain of the private equity Fortress Funds, of which €6.4 million ($9.1 million) has been repaid. The preferred equity does not pay a dividend.

In September 2007, six employees terminated their employment at Fortress in order to form a management company. A portfolio company owned by a Fortress Fund has contracted with this management company to perform services for one of its subsidiaries. These employees had received RSUs in connection with Fortress's IPO in February 2007. In connection with the above transactions, Fortress has modified these awards, valued at approximately $5.9 million in the aggregate, such that each employee's vesting continues on the original vesting schedule as long as both (i) such employee remains employed by the management company, and (ii) the management company continues to provide services to the subsidiary.

For the three and nine months ended September 30, 2007, other revenues included approximately $11.9 million and $32.3 million of revenues from affiliates, primarily expense reimbursements, respectively.

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7. EQUITY-BASED COMPENSATION

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

Granted To	Type of Award	Service Conditions	Entitled to Dividends	Accounting	September 30, 2007 Shares/Units Outstanding	Weighted Average Grant Date Estimated Value per Share/Unit	Weighted Average September 30, 2007 Estimated Value per Share/Unit (A) (B)
Employees	RSUs	Yes	Yes	Fair value at grant date (D) expensed over service period.	23,730,308	$ 18.50	N/A
	RSUs	Yes	No	Fair value at grant date (D) discounted for the non-entitlement to dividends, expensed over service period.	16,359,661	14.92	N/A
	RSUs	No	Yes	Fair value at grant date (D) discounted for post-vesting restrictions (delivery of shares as described in (B)), expensed at grant date.	394,286	22.11	N/A
	RSUs	No	No	Fair value at grant date (D) discounted for the non-entitlement to dividends and further discounted for post-vesting restrictions (delivery of shares as described in (B)), expensed at grant date.	634,287	11.50	N/A
	LTIP (C)	Yes (C)	(C)	Fair value at grant date, based on a valuation model, expensed over service period.	2,857,143	12.04	N/A
Directors	Restricted Shares	Yes	Yes	Fair value at grant date (D) expensed over service period.	97,296	18.50	N/A
Employees of our Private Equity Funds	RSUs	Yes	No	Fair value at grant date (D) discounted for the non-entitlement to dividends, expensed over service period. Subsequent changes in fair value, through the vesting date, expensed over remaining service period with a cumulative catch-up adjustment in the period of change.			

8,723,112 15.22 $ 15.87 Other Non- Employees RSUs Yes No Fair value at grant date (D) discounted for the non-entitlement to dividends, expensed over service period. Subsequent changes in fair value, through the vesting date, expensed over remaining service period with a cumulative catch-up adjustment in the period of change. 557,465 16.05 15.62

(A)

Generally, such awards vest 25% at each of January 1, 2010, 2011, 2012, and 2013 (for employees) and 33-1/3% after each of our annual meetings in 2008, 2009 and 2010 (for directors). Certain employees (primarily those hired after the IPO) have different vesting schedules. Vesting of these awards may be accelerated if an employee is terminated without cause, or in the event of death or disability, or a change in control of Fortress. (B) Vested Class A shares will be delivered to employee grant recipients 25% at each of, or within no more than six months after, January 1, 2010, 2011, 2012, and 2013. Director restricted shares were delivered effective on the grant date. Certain awards entitle the recipient to receive dividend equivalent payments prior to such delivery dates.

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(C)

Represents a profits interest in respect of certain Fortress Operating Group units that have a maximum value that corresponds to 2.9 million Fortress Operating Group units, granted by one of the Principals to one of Fortress's employees at the date of the IPO. The profits interests have a five-year cliff-vesting service condition. (D) For awards granted in connection with the IPO, the fair value is based on the IPO price. For awards granted subsequent to the IPO, the fair value is based on the closing price on the grant date of Fortress's Class A shares.

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

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

The discount related to RSUs which do not entitle the recipients to dividend equivalents prior to the delivery of Class A shares was based on the estimated present value of dividends to be paid during the vesting period, which in turn was based on an estimated initial dividend rate (between 2.25% and 5.27% based on the actual dividend rate on the grant date), an estimated dividend growth rate (20%) and a risk-free discount rate (between 3.85% and 5.17% based on grant date and term).

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

The estimated fair value of the LTIP award was estimated using a Monte Carlo simulation valuation model with the following assumptions: volatility (35%), term (equal to vesting period), and risk-free discount rate (4.79%) of like term.

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

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

	RSUs		Restricted Shares	LTIP	Total Equity-Based Compensation Expense
	Employees	Non-Employees			
Issued at IPO	42,212,312	8,521,070	97,296		
Issued subsequent to IPO	1,221,429	947,643	—		
Forfeited	(2,315,199)	(188,136)	—		
Outstanding at September 30, 2007 (A)	41,118,542	9,280,577	97,296		
Expense incurred during the nine months ended September 30, 2007	$ 82,280	$ 13,778	$ 385	$ 4,427	$ 100,870
Expense incurred during the three months ended September 30, 2007	$ 28,265	$ 5,300	$ 152	$ 2,853	$ 36,570

(A)

Fortress will further recognize, in the future, compensation expense on its non-vested equity-based awards of $750.1 million, with a weighted average recognition period of 5.27 years.

The Principals entered into an agreement among themselves (the ‘‘Principals Agreement’’) which provides that, in the event a Principal voluntarily terminates his employment with Fortress Operating Group for any reason prior to the fifth anniversary of the IPO, a portion of the equity interests held by that Principal as of the completion of the IPO will be forfeited to the Principals who are employed by Fortress Operating Group generally as of the date that is six months after the date of such termination of employment. As a result of the service requirement, the fair value of Fortress Operating Group units subject to the risk of forfeiture of $4,763 million will be charged to compensation expense on a straight-line basis over the five year service period, including $232.0 million and $613.0 million during the three and nine months ended September 30, 2007, respectively.

When Fortress records equity-based compensation expense, including that related to the Principals Agreement, it records a corresponding increase in capital. Of the total increase in capital during the nine months ended September 30, 2007 from equity-based compensation arrangements of $713.9 million, $166.0 million increased Fortress’s paid-in capital, as reflected in the Statement of Members’ and Shareholders’ Equity, and $547.9 million increased Principals’ interests in equity of consolidated subsidiaries corresponding to the Principals’ interest in the equity-based compensation expense.

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8. EARNINGS PER SHARE

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

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

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

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

January 17 through September 30, 2007	Basic	Diluted
Weighted average shares outstanding		
Class A shares outstanding	90,971,694	90,971,694
Fully vested restricted Class A share units with dividend equivalent rights	283,825	283,825
Fortress Operating Group units exchangeable into Fortress Investment Group LLC Class A shares(1)	—	—
Class A restricted shares and Class A restricted share units granted to employees and directors (eligible for dividend and dividend equivalent payments)(2)	—	—
Class A restricted share units granted to employees (not eligible for dividend and dividend equivalent payments)(3)	—	—
Total weighted average shares outstanding	91,255,519	91,255,519

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January 17 through September 30, 2007	Basic	Diluted
Basic and diluted net income (loss) per Class A share		
Net income (loss)	$ (163,942)	$ (163,942)
Dividend equivalents declared on non-vested restricted Class A share units	(2,742)	(2,742)
Dilution in earnings of certain equity method investees	—	—
Add back Principals’ and others’ interests in loss of Fortress Operating Group, net of assumed corporate income tax at enacted rates, attributable to Fortress Operating Group units exchangeable into Fortress Investment Group LLC Class A shares(1)	—	—
Net income (loss) available to Class A shareholders	$ (166,684)	$ (166,684)
Weighted average shares outstanding	91,255,519	91,255,519
Basic and diluted net income (loss) per Class A share	$ (1.83)	$ (1.83)

Three Months Ended September 30, 2007	Basic	Diluted
Weighted average shares outstanding		
Class A shares outstanding	94,500,350	94,500,350
Fully vested restricted Class A share units with dividend equivalent rights	394,286	394,286
Fortress Operating Group units exchangeable into Fortress Investment Group LLC Class A shares(1)	—	312,071,550
Class A restricted shares and Class A restricted share units granted to employees and directors (eligible for dividend and dividend equivalent payments)(2)	—	—
Class A restricted share units granted to employees (not eligible for dividend and dividend equivalent payments)(3)	—	—
Total weighted average shares outstanding	94,894,636	406,966,186

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Three Months Ended September 30, 2007 Basic Diluted Basic and diluted net income (loss) per Class A share Net income (loss) $ (37,557) $ (37,557) Dividend equivalents declared on non-vested restricted Class A share units (1,125) (1,125) Dilution in earnings of certain equity method investees — — Add back Principals' and others' interests in loss of Fortress Operating Group, net of assumed corporate income tax at enacted rates, attributable to Fortress Operating Group units exchangeable into Fortress Investment Group LLC Class A shares(1) — (173,093) Net income (loss) available to Class A shareholders $ (38,682) $ (211,775) Weighted average shares outstanding 94,894,636 406,966,186 Basic and diluted net income (loss) per Class A share $ (0.41) $ (0.52)

(1) The Fortress Operating Group units not held by Fortress (that is, those held by the Principals) are exchangeable into Class A shares on a one-to-one basis. These units are not included in the computation of basic earnings per share. These units enter into the computation of diluted net income (loss) per Class A share when the effect is dilutive using the if-converted method. Under the if-converted method the Principals' and others' interests in income (loss) of Fortress Operating Group attributable to the units, net of assumed corporate income tax, is added to the net loss in the numerator of the computation and the Class A shares available from the assumed conversion of the Fortress Operating Group units, as if it had occurred at the beginning of the period, is added to the denominator. For the year-to-date period, the effect of including the units would have been antidilutive. The weighted average number of Fortress Operating Group units outstanding for the periods from January 17, 2007 through September 30, 2007 and the three months ended September 30, 2007 were 312,071,550 units. (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 our Class A shares and therefore participate fully in the results of our operations from the date they are granted. They are included in the computation of both basic and diluted pro forma earnings per Class A share using the two-class method for participating securities, except during periods of net losses in accordance with EITF 03-6, ''Participating Securities and the Two-Class Method under FASB Statement No. 128.'' The weighted average restricted Class A shares and share units eligible to receive dividend or dividend equivalent payments outstanding for the periods from January 17, 2007 through September 30, 2007 and the three months ended September 30, 2007 were 88,588 and 97,296 shares, respectively, and 21,702,604 and 23,730,308 share units, respectively. (3) Certain restricted Class A share units granted to employees are not entitled to dividend or dividend equivalent payments until they are vested and are therefore non-participating securities. These units are not included in the computation of basic earnings per share. They are included in the computation of diluted earnings per share when the effect is dilutive using the treasury stock method. As a result of the net loss incurred for the period, the effect of the units on the calculation is anti-dilutive for the periods. The weighted average restricted Class A share units

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which are not entitled to receive dividend or dividend equivalent payments outstanding for the periods from January 17, 2007 through September 30, 2007 and the three months ended September 30, 2007 were 23,462,014 and 26,087,366 share units, respectively.

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

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

	Weighted Average Three Months Ended September 30, 2007	Weighted Average Nine Months Ended September 30, 2007	September 30, 2007
Class A shares	94,500,350	85,640,019	94,500,350
Restricted Class A share units (A)	394,286	267,190	394,286
Restricted Class A shares	97,296	83,396	97,296
Restricted Class A share units	23,730,308	20,430,657	23,730,308
Fortress Operating Group units	312,071,550	315,299,181	312,071,550
Total	430,793,790	421,720,443	430,793,790

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

Dividends and distributions during the nine months ended September 30, 2007 are summarized as follows:

	Declared in Prior Year, Paid Current Year	Current Year Declared and Paid	Current Year Declared but not yet Paid	Total
Dividends on Class A Shares	$ —	$ 35,348	$ 21,285	$ 56,633
Dividend equivalents on restricted Class A share units (A)	—	8,383	5,428	13,811
Distributions to Fortress Operating Group unit				

holders (Principals) — 204,117 16,616 220,733 Predecessor distributions (prior to January 17, 2007) — 415,876 — 415,876 Total distributions $ — $ 663,724 $ 43,329 $ 707,053

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

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9. COMMITMENTS AND CONTINGENCIES

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

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

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

On September 15, 2005, a lawsuit captioned David T. Atkins et al. v. Apollo Real Estate Advisors, L.P. et al. was brought on behalf of current and former limited partners in certain investing partnerships related to the sale of certain facilities to Ventas Realty Limited Partnership (''Ventas'') against a number of defendants, including one of the Portfolio Companies and a subsidiary of Fortress (''FIG''). FIG was the investment manager of consolidated Fortress Funds that were controlling shareholders of the Portfolio Company during the relevant time periods. The suit alleges that the defendants improperly obtained certain rights with respect to such facilities from the investing partnerships. The plaintiffs have asked for damages in excess of $100 million on each of nine counts, as to which FIG is a defendant on seven counts, including treble damages with respect to certain counts. Fortress has filed an action to have itself removed as a named defendant in this case. The Portfolio Company has filed a motion to dismiss the claims and continues to vigorously defend this action. Fortress believes that the resolution of this action will not have a material adverse effect on its financial condition, liquidity or results of operations.

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

Regulatory Matters — In the ordinary course of business, Fortress ands its subsidiaries and equity method investees may be subject to regulatory examinations, information gathering requests, inquiries or investigations. Management, after consultation with legal counsel, does not believe these matters will ultimately have a material effect on Fortress.

Private Equity Fund and Other Capital Commitments — Fortress has remaining capital commitments to certain of the Fortress Funds which aggregated $181.1 million at September 30, 2007. These commitments can be drawn by the funds on demand. In addition, Fortress is contingently liable for certain general and administrative expenses of the private equity Fortress Funds, to the extent they exceed approved limits. Management does not expect to make any material payments under this obligation.

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

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

The following is a summary of major lease terms:

	New York Leases	Other Leases
Lease end date	Dec-2016	Various dates through Apr-2012
Current annual rent	$6,725	$6,129
Scheduled rent changes	Year 5 to $6,840; Year 9 to $5,725	Varies by lease
Escalations	Generally, a fixed percentage of the landlord's annual operating expenses and tax expense.	Generally, a fixed percentage of the landlord's annual operating expenses and tax expense.
Free rent periods	6 – 9 months	4 – 12 months
Leasehold improvement incentives	$3,186	$505
Renewal periods	None	5-year option on one lease, remainder have none

Minimum future rental expense under these leases is as follows:

October 1 to December 31, 2007	$ 3,414
2008	13,676
2009	12,909
2010	12,455
2011	9,346
2012	6,206
Thereafter	22,857
Total	$ 80,863

Rent expense recognized on a straight-line basis during the nine months ended September 30, 2007 and 2006 was $11.0 million and $6.7 million, respectively, and during the three months ended September 30, 2007 and 2006 was $3.6 million and $3.0 million, respectively, and was included in General, Administrative and Other Expense.

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10. SEGMENT REPORTING

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

The amounts not allocated to a segment consist primarily of interest income earned on short term investments, certain general and administrative expenses and all interest expense incurred with respect to corporate borrowings. Where applicable, portions of the general and administrative expenses have been allocated between the segments.

Management makes operating decisions and assesses performance with regard to each of Fortress's primary segments based on financial data that is presented without the consolidation of any Fortress Funds. Accordingly, segment data for these segments is reflected on an unconsolidated basis, even for periods prior to the deconsolidation (Note 1). Management also assesses Fortress's segments on a Fortress Operating Group and pre-tax basis and therefore adds back the interests in consolidated subsidiaries related to Fortress Operating Group units (held by the Principals) and income tax expense.

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

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

Incentive Income

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

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

Other Income

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

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

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

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

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

Expenses

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

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

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

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

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

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

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

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

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

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

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(ii) employee portions of investments, which are reported gross for GAAP purposes (as assets offset by Principals' and others' interests in equity of consolidated subsidiaries) but net for segment reporting purposes, and (iii) the difference between the GAAP carrying amount for options owned in certain of the Castles and their carrying amount for segment reporting purposes, which is intrinsic value.

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

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

	Nine Months Ended September 30,	
	2007	2006
Liquid hedge funds	$ 1,926	$ 49,660
Hybrid hedge funds	—	9,467
Total	$ 1,926	$ 59,127

	Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds	Castles	Unallocated	Fortress Unconsolidated Subtotal
September 30, 2007 and the Nine Months Then Ended						
Segment revenues						
Management fees	$ 97,749	$ 113,692	$ 94,096	$ 34,877	$ —	$ 340,414
Incentive income	273,890	157,989	93,832	18,596	—	544,307
Segment revenues – total	$ 371,639	$ 271,681	$ 187,928	$ 53,473	$ —	$ 884,721
Pre-tax distributable earnings	$ 258,507	$ 131,637	$ 81,710	$ 25,315	$ (23,580)	$ 473,589
Total segment assets	$ 509,218	$ 57,719	$ 331,598	$ 120,618	$ 720,860 (A)	$ 1,740,013

Fortress
Unconsolidated

	Subtotal	Consolidation of Fortress Funds	Eliminations	Reconciliation to GAAP	Fortress Consolidated
Revenues	$ 884,721	$ 317,114	$ (269,607)	$ (497)	$ 931,731
Pre-tax distributable earnings/net income	$ 473,589	$ (326,375)	$ 326,375	$ (504,134)	$ (30,545)
Total assets	$ 1,740,013	$ —	$ —	$ 67,569	$ 1,807,582

(A)

Unallocated assets include cash of $169 million and deferred tax assets of $490 million.

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September 30, 2007 and the Nine Months Then Ended
Reconciling items between segment measures and GAAP measures:

Adjustments from segment revenues to GAAP revenues Adjust management fees* $ 488 Adjust incentive income (48,316) Adjust income from the receipt of options 2,006 Other revenues* 45,325 Total adjustments $ (497)

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

Adjustments from pre-tax distributable earnings to GAAP net income Adjust incentive income Incentive income received from private equity funds, subject to contingent repayment $ (191,948) Incentive income received from private equity funds, not subject to contingent repayment (73,644) Incentive income accrued from private equity funds, no longer subject to contingent repayment 309,275 Incentive income received from hedge funds, subject to annual performance achievement (91,999) Reserve for clawback — (48,316) Adjust other income Distributions of earnings from equity method investees** (13,741) Earnings (losses) from equity method investees** (49,762) Unrealized gains (losses) on options in equity method investees, treated as derivatives (82,810) Adjust income from the receipt of options 2,006 (144,307) Adjust employee compensation Adjust employee equity-based compensation expense (including Castle options assigned) (99,014) Adjust employee portion of incentive income from one private equity fund, not subject to contingent repayment 5,427 (93,587) Adjust Principals' equity-based compensation expense (612,981) Adjust non-controlling interests related to Fortress Operating Group units 402,294 Adjust income taxes (7,237) Total adjustments $ (504,134)

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

Adjustments from total segment assets to GAAP assets Adjust equity investments from fair value $ (36,946) Adjust equity investments from cost 24,190 Adjust investments gross of employee portion 72,702 Adjust option investments to intrinsic value 7,623 Total adjustments $ 67,569

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	Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds	Castles	Unallocated	Fortress Unconsolidated Subtotal
Three Months Ended September 30, 2007						
Segment revenues						
Management fees	$ 35,133	$ 44,351	$ 33,376	$ 12,131	$ —	$ 124,991
Incentive income	83,592	(210)	9,463	691	—	93,536
Segment revenues – total	$ 118,725	$ 44,141	$ 42,839	$ 12,822	$ —	$ 218,527
Pre-tax distributable earnings	$ 82,303	$ 19,535	$ 9,994	$ 4,609	$ (5,689)	$ 110,752

	Fortress Unconsolidated Subtotal	Reconciliation to GAAP	Fortress Consolidated
Revenues	$ 218,527	$ 28,755	$ 247,282
Pre-tax distributable earnings/net income	$ 110,752	$ (148,309)	$ (37,557)

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

Adjustments from segment revenues to GAAP revenues	
Adjust management fees*	$ 163
Adjust incentive income	13,477
Adjust income from the receipt of options	—
Other revenues*	15,115
Total adjustments	$ 28,755

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

Adjustments from pre-tax distributable earnings to GAAP net income		
Adjust incentive income		
Incentive income received from private equity funds, subject to contingent repayment	$ (53,126)	
Incentive income received from private equity funds, not subject to contingent repayment	(22,168)	
Incentive income accrued from private equity funds, no longer subject to contingent repayment	97,333	
Incentive income received from hedge funds, subject to annual performance achievement	(8,562)	
Reserve for clawback	—	
		13,477
Adjust other income		
Distributions of earnings from equity method investees**	(1,415)	
Earnings (losses) from equity method investees**	(30,514)	
Unrealized gains (losses) on options in equity method investees, treated as derivatives	(58,354)	
Adjust income from the receipt of options	—	
		(90,283)
Adjust employee compensation		
Adjust employee equity-based compensation expense (including Castle options assigned)	(31,651)	
Adjust employee portion of incentive income from private equity funds, accrued prior to the realization of incentive income	19,657	
Adjust employee portion of incentive income from one private equity fund, not subject to contingent repayment	5,427	
		(6,567)
Adjust Principals' equity-based compensation expense		(232,048)
Adjust non-controlling interests related to Fortress Operating Group units		154,893
Adjust income taxes		12,219
Total adjustments		$ (148,309)

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

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	Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds	Castles	Unallocated	Fortress Unconsolidated Subtotal
Nine Months Ended September 30, 2006						
Segment revenues						
Management fees	$ 59,605	$ 63,919	$ 57,240	$ 23,116	$ —	$ 203,880
Incentive income	96,176	80,135	86,644	11,567	—	274,522
Segment revenues – total	$ 155,781	$ 144,054	$ 143,884	$ 34,683	$ —	$ 478,402
Pre-tax distributable earnings	$ 112,433	$ 109,457	$ 66,236	$ 8,966	$ (37,919)	$ 259,173

	Fortress Unconsolidated Subtotal	Consolidation of Fortress Funds	Eliminations	Reconciliation to GAAP	Fortress Consolidated
Revenues	$ 478,402	$ 913,548	$ (207,747)	$ (150,735)	$ 1,033,468
Pre-tax distributable earnings/ net income	$ 259,173	$ 3,057,107	$ (3,057,107)	$ (106,463)	$ 152,710

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Reconciling items between segment measures and GAAP measures:

Adjustments from segment revenues to GAAP revenues	
Adjust management fees*	$ (120)
Adjust incentive income	(173,132)
Adjust income from the receipt of options	18,692
Other revenues*	3,825
Total adjustments	$ (150,735)

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

Adjustments from pre-tax distributable earnings to GAAP net income		
Adjust incentive income		
Incentive income received from private equity funds, subject to contingent repayment	$ (96,176)	
Incentive income accrued from private equity funds, no longer subject to contingent repayment	8,613	
Incentive income accrued from hedge funds, subject to annual performance achievment	(85,569)	
Reserve for clawback	—	
		(173,132)
Adjust other income		
Distributions of earnings from equity method investees**	(6,223)	
Earnings (losses) from equity method investees**	35,800	
Unrealized gains (losses) on options in equity method investees, treated as derivatives	36,897	
Adjust income from the receipt of options	18,692	
		85,166
Adjust employee compensation		
Adjust compensation expense for assigned Castle options	(7,577)	
Adjust employee portion of incentive income from one private equity fund, not subject to contingent payment	(2,109)	
		(9,686)
Adjust income taxes		(8,811)
Total adjustments		$ (106,463)

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

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	Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds	Castles	Unallocated	Fortress Unconsolidated Subtotal
Three Months Ended September 30, 2006						
Segment revenues						
Management fees	$ 21,958	$ 23,496	$ 21,208	$ 8,106	$ —	$ 74,768
Incentive income	—	9,226	33,137	5,098	—	47,461
Segment revenues – total	$ 21,958	$ 32,722	$ 54,345	$ 13,204	$ —	$ 122,229
Pre-tax distributable earnings	$ 17,353	$ 31,831	$ 28,148	$ 6,894	$ (17,212)	$ 67,014

	Fortress Unconsolidated Subtotal	Consolidation of Fortress Funds	Eliminations	Reconciliation to GAAP	Fortress Consolidated
Revenues	$ 122,229	$ 301,647	$ (60,803)	$ (27,905)	$ 335,168
Pre-tax distributable earnings/ net income	$ 67,014	$ 1,592,772	$ (1,592,772)	$ (2,309)	$ 64,705

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Reconciling items between segment measures and GAAP measures:

Adjustments from segment revenues to GAAP revenues Agjust management fees* $ (450) Adjust incentive income (29,245) Adjust income from the receipt of options — Other revenues* 1,790 Total adjustments $ (27,905)

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

Adjustments from pre-tax distributable earnings to GAAP net income Adjust incentive income Incentive income received from private equity funds, subject to contingent repayment $ — Incentive income accrued from private equity funds, no longer subject to contingent repayment 3,153 Incentive income accrued from hedge funds, subject to annual performance achievment (32,398) Reserve for clawback — (29,245) Adjust other income Distributions of earnings from equity method investees** (1,154) Earnings (losses) from equity method investees** 25,175 Unrealized gains (losses) on options in equity method investees, treated as derivatives 12,893 Adjust income from the receipt of options — 36,914 Adjust employee compensation Adjust compensation expense for assigned Castle options (7,642) Adjust employee portion of incentive income from one private equity fund, not subject to contingent payment (772) (8,414) Adjust income taxes (1,564) Total adjustments $ (2,309)

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

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Fortress's depreciation expense by segment was as follows:

		Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds	Castles	Unallocated	Total
Nine Months Ended September 30,	2007	$ 747	$ 1,860	$ 1,926	$ 633	$ 1,257	$ 6,423
	2006	$ 510	$ 1,317	$ 1,590	$ 481	$ 946	$ 4,844
Three Months Ended September 30,	2007	$ 265	$ 649	$ 697	$ 207	$ 412	$ 2,230
	2006	$ 173	$ 451	$ 550	$ 162	$ 322	$ 1,658

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11. SUBSEQUENT EVENTS

In October 2007, Fortress made an additional €37.9 million ($54.1 million) investment in one of its private equity funds, beyond its prior commitment. See Note 6 for more information on this transaction.

In October 2007, Fortress committed to invest, alongside certain of Fortress's private equity funds known as the Drawbridge Long Dated Value Funds (including a newly formed Drawbridge Long Dated Value Co-Invest Fund), in companies that recently acquired a portfolio of intellectual property. In connection with this, Fortress, its affiliates and employees committed approximately €80 million ($114 million) of the total commitments to this investment. The transaction is subject to regulatory clearance and is expected to close in the fourth quarter.

12. PRO FORMA FINANCIAL INFORMATION

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

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

- Fortress no longer records on its balance sheet and statement of operations the gross assets, liabilities, revenues, expenses and other income of the deconsolidated Fortress Funds, along with the related interests of the fund investors in the equity and net income of these funds.
- Fortress reflects its investment in these funds on its balance sheet using the equity method of accounting, rather than eliminating the investment in consolidation.
- Fortress will include the management fees and incentive income earned from these funds on its statement of operations rather than eliminating the revenue in consolidation.
- Fortress will record its equity in the income of these funds using the equity method of accounting. However, it will not record any equity in income arising from incentive income arrangements to the extent that the incentive income is subject to contingent repayment until the contingency is resolved. Therefore, Fortress no longer needs to record deferred incentive income with respect to these funds for incentive income that it is not yet distributed.

- Fortress will also remove the cash flow activities of the deconsolidated funds from its statement of cash flows and replace them with its cash contributions to and distributions from the deconsolidated funds, which previously were eliminated in consolidation. This would not have any effect on Fortress's overall net change in cash for the period; however, it would result in significant changes to Fortress's operating, investing and financing cash flow categories.

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

As of December 31, 2006	Combined	Deconsolidation Adjustments	Pro Forma Deconsolidated
Assets			
Cash and cash equivalents	$ 61,120	$ —	$ 61,120
Cash held at consolidated subsidiaries and restricted cash	564,085	(564,085)	—
Due from affiliates	635,748	50,336	686,084
Receivables from brokers and counterparties	109,463	(109,463)	—
Investment company holdings, at fair value	21,944,596	(21,944,596)	—
Other investments			
Loans and securities	317	—	317
Equity method investees	37,250	452,143	489,393
Options in affiliates	139,266	—	139,266
Deferred tax asset	2,808	—	2,808
Other assets	187,920	(118,200)	69,720
	$ 23,682,573	$ (22,233,865)	$ 1,448,708
Liabilities and Members' Equity			
Liabilities			
Due to affiliates	$ 15,112	$ (14,660)	$ 452
Due to brokers and counterparties	187,495	(187,495)	—
Accrued compensation and benefits	159,931	—	159,931
Other liabilities	152,604	(95,413)	57,191
Deferred incentive income	1,648,782	(1,408,700)	240,082
Securities sold not yet purchased, at fair value	97,717	(97,717)	—
Derivative liabilities, at fair value	123,907	(122,288)	1,619
Investment company debt obligations payable	2,619,456	(2,619,456)	—
Other debt obligations payable	687,153	—	687,153
	5,692,157	(4,545,729)	1,146,428
Commitments and Contingencies			
Principals' and Others' Interests in Equity of Consolidated Subsidiaries	17,868,895	(17,688,136)	180,759
Members' Equity			
Members' equity	119,561	—	119,561
Accumulated other comprehensive income	1,960	—	1,960
	121,521	—	121,521
	$ 23,682,573	$ (22,233,865)	$ 1,448,708

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

The unaudited pro forma effects of the deconsolidation of the Fortress Funds on the statement of operations information are as follows:

Nine Months Ended September 30, 2007	Consolidated	Deconsolidation Adjustments	Pro Forma Deconsolidated
Revenues			
Management fees from affiliates	$ 286,956	$ 53,072	$ 340,028
Incentive income from affiliates	283,879	211,682	495,561
Other revenues	51,866	(3,232)	48,634
Interest and dividend income – investment company holdings	309,030	(309,030)	—
	931,731	(47,508)	884,223
Expenses			
Interest expense			
Investment company holdings	132,620	(132,620)	—
Other	26,016	—	26,016
Compensation and benefits	507,003	(9,805)	497,198
Principals agreement compensation	612,981	—	612,981
General, administrative and other	80,320	(22,024)	58,296
Depreciation and amortization	6,423	—	6,423
	1,365,363	(164,449)	1,200,914
Other income			
Gains (losses) from investments			
Investment company holdings	(647,477)	647,477	—
Other investments			
Net realized gains	831	—	831
Net realized gains from affiliate investments	143,017	—	143,017
Net unrealized gains (losses)	(2,597)	—	(2,597)
Net unrealized gains (losses) from affiliate investments	(221,745)	—	(221,745)
Earnings (losses) from equity method investees	(23,289)	3,231	(20,058)
	(751,260)	650,708	(100,552)
Income (loss) before Deferred Incentive Income, Principals’ and Others’ Interests in Income of Consolidated Subsidiaries and Income Taxes	(1,184,892)	767,649	(417,243)
Deferred incentive income	307,034	(307,034)	—
Principals’ and others’ interests in loss (income) of consolidated subsidiaries	854,550	(460,615)	393,935
Income (Loss) Before Income Taxes	(23,308)	—	(23,308)
Income tax expense	(7,237)	—	(7,237)
Net Income (Loss)	$ (30,545)	$ —	$ (30,545)

The pro forma deconsolidated net gains and losses disclosed above of ($80.5 million) include approximately ($79.3 million) of loss on Eurocastle options, $2.9 million of gains on deferred fee arrangements and ($3.5 million) of impairment loss on Newcastle options.

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

The unaudited pro forma effects of the deconsolidation of the Fortress Funds on the statement of cash flows information are as follows:

Nine Months Ended September 30, 2007	Consolidated	Deconsolidation Adjustments	Pro Forma Deconsolidation
Cash Flows From Operating Activities			
Net income (loss)	$ (30,545)	$ —	$ (30,545)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities			
Depreciation and amortization	6,423	—	6,423
Other amortization and accretion	1,876	(483)	1,393
(Earnings) losses from equity method investees	23,289	(3,231)	20,058
Distributions of earnings from equity method investees	9,765	3,231	12,996
(Gains) losses from investments	727,971	(647,477)	80,494
Recognition of deferred incentive income	—	(156,326)	(156,326)
Deferred incentive income	(355,381)	307,034	(48,347)
Principals’ and others’ interests in income of consolidated subsidiaries	(854,550)	460,615	(393,935)
Deferred tax expense	(16,775)	—	(16,775)
Options received from affiliates	(2,006)	—	(2,006)
Assignments of options to employees	4,627	—	4,627
Equity-based compensation	713,850	—	713,850
Cash flows due to changes in			
Cash held at consolidated subsidiaries and restricted cash	(166,199)	166,199	—
Due from affiliates	562,731	87,199	649,930
Receivables from brokers and counterparties and other assets	(23,024)	32,131	9,107
Due to affiliates	(6,392)	8,594	2,202
Accrued compensation and benefits	48,174	(144)	48,030
Deferred incentive income	—	142,041	142,041
Due to brokers and counterparties and other liabilities	118,098	(87,935)	30,163
Investment company holdings			
Purchases of investments	(5,105,865)	5,105,865	—
Proceeds from sale of investments	3,398,739	(3,398,739)	—
Net cash provided by (used in) operating activities	(945,194)	2,018,574	1,073,380
Cash Flows From Investing Activities			
Purchase of other loan and security investments	(10,578)	—	(10,578)
Proceeds from sale of other loan and security investments	317	—	317
Contributions to equity method investees	(560,272)	(148,812)	(709,084)
Proceeds from sale of equity method investments	29,071	—	29,071
Distributions of capital from equity method investees	115,190	22,685	137,875
Cash received on settlement of derivatives	132	—	132
Purchase of fixed assets	(8,907)	125	(8,782)
Proceeds from disposal of fixed assets	2,532	—	2,532
Net cash used in investing activities	(432,515)	(126,002)	(558,517)
Cash Flows From Financing Activities			
Borrowings under debt obligations	1,999,070	(1,564,070)	435,000
Repayments of debt obligations	(2,010,025)	1,312,872	(697,153)
Payment of deferred financing costs	(6,813)	660	(6,153)
Issuance of Class A shares to Nomura	888,000	—	888,000
Issuance of Class A shares in initial public offering	729,435	—	729,435
Costs related to initial public offering	(76,766)	—	(76,766)
Dividends and dividend equivalents paid	(43,237)	—	(43,237)
Fortress Operating Group capital distributions to Principals	(415,876)	—	(415,876)
Purchase of Fortress Operating Group units from Principals	(888,000)	—	(888,000)
Principals’ and others’ interests in equity of consolidated subsidiaries – contributions	3,249,847	(3,205,436)	44,411
Principals’ and others’ interests in equity of consolidated subsidiaries –			

distributions (1,939,554) 1,563,402 (376,152) Net cash provided by (used in) financing activities 1,486,081 (1,892,572) (406,491) Net Increase in Cash and Cash Equivalents 108,372 — 108,372 Cash and Cash Equivalents, Beginning of Period 61,120 — 61,120 Cash and Cash Equivalents, End of Period $ 169,492 $ — $ 169,492

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

NOTE 13 — 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, 2007. The statement of operations and statement of cash flows are presented on a pro forma basis for the effects of the deconsolidation as described in Note 12.

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 as well as the relevant ratios for borrowing entities.

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

The consolidating balance sheet information is as follows:

As of September 30, 2007	Fortress Operating Group Combined	Fortress Investment Group LLC Consolidated (A)	Elimination Adjustments	Fortress Investment Group LLC Consolidated
Assets				
Cash and cash equivalents	$ 152,917	$ 16,575	$ —	$ 169,492
Due from affiliates	39,872	5,037	(5,037)	39,872
Other investments				
Loans and securities	11,327	—	—	11,327
Equity method investees	990,441	79,191	(79,191)	990,441
Options in affiliates	48,351	—	—	48,351
Deferred tax asset	5,806	483,995	—	489,801
Other assets	58,298	—	—	58,298
	$ 1,307,012	$ 584,798	$ (84,228)	$ 1,807,582
Liabilities and Members' Equity				
Liabilities				
Due to affiliates	$ 19,269	$ 390,383	$ —	$ 409,652
Accrued compensation and benefits	192,589	—	—	192,589
Dividends payable	5,037	21,285	(5,037)	21,285
Other liabilities	64,957	5,620	—	70,577
Deferred incentive income	177,450	—	—	177,450
Derivative liabilities, at fair value	5,132	—	—	5,132
Other debt obligations payable	425,000	—	—	425,000
	889,434	417,288	(5,037)	1,301,685
Commitments and Contingencies				
Principals' and Others' Interests in Equity of Consolidated Subsidiaries	76,504	—	261,883	338,387
Members'/Shareholders' Equity (B)				
Members'/Shareholders' equity (B)	347,696	169,050	(347,696)	169,050
Accumulated other comprehensive income	(6,622)	(1,540)	6,622	(1,540)
	341,074	167,510	(341,074)	167,510
	$ 1,307,012	$ 584,798	$ (84,228)	$ 1,807,582

(A) Other than Fortress Operating Group (B) Represents shareholders' paid-in capital and retained earnings in the last column.

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

The consolidating pro forma statement of operations information is as follows:

Nine Months Ended September 30, 2007	Fortress Operating Group Consolidated	Fortress Investment Group LLC Consolidated (A)	Elimination Adjustments	Fortress Investment Group LLC Consolidated
Revenues				
Management fees from affiliates	$ 340,028	$ —	$ —	$ 340,028
Incentive income from affiliates	495,561	—	—	495,561
Other revenues	48,596	38	—	48,634
	884,185	38	—	884,223
Expenses				
Interest expense	26,016	—	—	26,016
Compensation and benefits	497,198	—	—	497,198
Principals agreement compensation	612,981	—	—	612,981
General, administrative and other	58,296	—	—	58,296
Depreciation and amortization	6,423	—	—	6,423
	1,200,914	—	—	1,200,914
Other Income				
Gains (losses) from investments				
Net realized gains	831	—	—	831
Net realized gains from affiliate investments	143,017	—	—	143,017
Net unrealized gains (losses)	(2,597)	—	—	(2,597)
Net unrealized gains (losses) from affiliate investees	(221,745)	—	—	(221,745)
Earnings (losses) from equity method investees	(20,058)	(155,775)	155,775	(20,058)
	(100,552)	(155,775)	155,775	(100,552)
Income (Loss) Before Principals’ and Others’ Interests in Income of Consolidated Subsidiaries and Income Taxes	(417,281)	(155,737)	155,775	(417,243)
Principals’ and others’ interests in loss (income) of consolidated subsidiaries	(8,359)	—	402,294	393,935
Income Before Income Taxes	(425,640)	(155,737)	558,069	(23,308)
Income tax benefit (expense)	968	(8,205)	—	(7,237)
Net Income	$ (424,672)	$ (163,942)	$ 558,069	$ (30,545)

(A) Other than Fortress Operating Group.

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

The consolidating pro forma statement of cash flows information is as follows:

	Nine Months Ended September 30, 2007			
	Fortress Operating Group Consolidated	Fortress Investment Group LLC Consolidated (A)	Elimination Adjustments	Fortress Investment Group LLC Consolidated
Cash Flows From Operating Activities				
Net income (loss)	$ (424,672)	$ (163,942)	$ 558,069	$ (30,545)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities				
Depreciation and amortization	6,423	—	—	6,423
Other amortization and accretion	1,393	—	—	1,393
(Earnings) losses from equity method investees	20,058	155,775	(155,775)	20,058
Distributions of earnings from equity method investees	12,996	—	—	12,996
(Gains) losses from investments	80,494	—	—	80,494
Recognition of deferred incentive income	(156,326)	—	—	(156,326)
Deferred incentive income	(48,347)	—	—	(48,347)
Principals' and others' interests in income (loss) of consolidated subsidiaries	8,359	—	(402,294)	(393,935)
Deferred tax expense	(12,190)	(4,585)	—	(16,775)
Options received from affiliates	(2,006)	—	—	(2,006)
Assignments of options to employees	4,627	—	—	4,627
Equity-based compensation	713,850	—	—	713,850
Cash flows due to changes in				
Due from affiliates	649,930	5,037	(5,037)	649,930
Receivables from brokers and counterparties and other assets	13,692	(4,585)	—	9,107
Due to affiliates	2,202	—	—	2,202
Accrued compensation and benefits	48,030	—	—	48,030
Deferred incentive income	142,041	—	—	142,041
Due to brokers and counterparties and other liabilities	19,959	5,167	5,037	30,163
Net cash provided by (used in) operating activities	1,080,513	(7,133)	—	1,073,380
Cash Flows From Investing Activities				
Purchase of other loan and security investments	(10,578)	—	—	(10,578)
Proceeds from sale of other loan and security investments	317	—	—	317
Contributions to equity method investees	(709,084)	(1,540,669)	1,540,669	(709,084)
Proceeds from sale of equity method investments	29,071	—	—	29,071
Distributions of capital from equity method investees	137,875	59,055	(59,055)	137,875
Cash received on settlement of derivatives	132	—	—	132
Purchase of fixed assets	(8,782)	—	—	(8,782)
Proceeds from disposal of fixed assets	2,532	—	—	2,532
Net cash used in investing activities	(558,517)	(1,481,614)	1,481,614	(558,517)
Cash Flows From Financing Activities				
Borrowings under debt obligations	435,000	—	—	435,000
Repayments of debt obligations	(697,153)	—	—	(697,153)
Payment of deferred financing costs				

(6,153) — — (6,153) Issuance of Class A shares to Nomura — 888,000 — 888,000 Issuance of Class A shares in initial public offering — 729,435 — 729,435 Costs related to initial public offering — (76,766) — (76,766) Dividends and dividend equivalents paid (271,062) (35,347) 263,172 (43,237) Capital contributions 652,669 — (652,669) — Fortress Operating Group capital distributions to Principals (415,876) — — (415,876) Purchase of Fortress Operating Group units from Principals — — (888,000) (888,000) Principals' and others' interests in equity of consolidated subsidiaries – contributions 44,411 — — 44,411 Principals' and others' interests in equity of consolidated subsidiaries – distributions (172,035) — (204,117) (376,152) Net cash provided by (used in) financing activities (430,199) 1,505,322 (1,481,614) (406,491) Net Increase in Cash and Cash Equivalents 91,797 16,575 — 108,372 Cash and Cash Equivalents, Beginning of Period 61,120 — — 61,120 Cash and Cash Equivalents, End of Period $ 152,917 $ 16,575 $ — $ 169,492

(A) Other than Fortress Operating Group

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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 and combined 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.

During the first quarter of 2007, we consummated a number of significant transactions, including the Nomura transaction, the formation transactions, our initial public offering, and the deconsolidation of a number of Fortress Funds. The deconsolidation of the Fortress Funds has had significant effects on many of the items within our financial statements but had no net effect on net income or equity. Since the deconsolidation did not occur until March 31, 2007, the statement of operations and the statement of cash flows for the nine months ended September 30, 2007 are presented including these funds on a consolidated basis for the period prior to deconsolidation. The pro forma effects of the deconsolidation on these financial statements are described in Note 12 to Part I, Item 1, ''Financial Statements — Pro Forma Financial Information.''

General

Our Business

Fortress is a leading global alternative asset manager with approximately $39.9 billion in AUM as of September 30, 2007. We raise, invest and manage private equity funds, hedge funds and publicly traded alternative investment vehicles. We earn management fees based on the size of our funds, incentive income based on the performance of our funds, and investment income from our principal investments in those funds. We invest capital in each of our businesses.

As of September 30, 2007, we managed approximately $39.9 billion of alternative assets in three core businesses:

Private Equity Funds — a business that manages approximately $20.9 billion of AUM that primarily makes significant, control-oriented investments in North America and Western Europe, with a focus on acquiring and building asset-based businesses with significant cash flows. We also manage a family of ''long dated value'' funds focused on investing in undervalued assets with limited current cash flows and long investment horizons;

Hedge Funds — a business that manages approximately $15.9 billion of AUM comprised of two business segments; (i) hybrid hedge funds — which make highly diversified investments globally in assets, opportunistic lending situations and securities through the capital structure with a value orientation, as well as investment funds managed by external managers; and (ii) 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; and

Publicly Traded Alternative Investment Vehicles, which we refer to as ''Castles'' — approximately $3.1 billion of aggregate market capitalization in two publicly traded companies managed by us. The Castles currently invest primarily in real estate and real estate debt investments.

Managing Business Performance

We conduct our management and investment business through the following four primary segments: (i) private equity funds, (ii) liquid hedge funds, (iii) hybrid hedge funds, and (iv) Castles. These segments are differentiated based on the varying investment strategies of the funds we manage in each segment.

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

Management makes operating decisions and assesses performance with regard to each of our primary segments based on financial data that is presented without the consolidation of any Fortress Funds. Accordingly, segment data for these segments is reflected on an unconsolidated basis, even for periods prior to the deconsolidation. Management also assesses our segments on a Fortress Operating Group and pre-tax basis, and therefore adds back the non-controlling interests in consolidated subsidiaries related to Fortress Operating Group units (held by the principals) and income tax expense.

Management assesses the net performance of each segment based on its ‘‘distributable earnings.’’ Distributable earnings is not a measure of cash generated by operations which is available for distribution. Rather distributable earnings is a supplemental measure of the value created during any period which management uses in its determination of its periodic distributions to its dividend paying share and unit equity holders. 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 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, see ‘‘— Results of Operations — Segments Analysis’’ below.

Public Company Surplus

Our private equity funds have sponsored the initial public offerings of six portfolio companies since 2004 and have invested in one of the Castles whose initial public offering was sponsored directly by us. Our funds’ investments (including those of hedge funds) in these public companies include $3.1 billion of unrealized gains based on their stock prices as of September 28, 2007. Our share of those profits, which we call our private equity unrealized ‘‘public company surplus,’’ represents Fortress’s unrealized potential incentive income in respect of these investments. This potential incentive income is not reflected currently in our revenues. The periods in which such incentive income will be realized on a distributable earnings basis will be a function of our decisions regarding the timing of realization of fund investments in our portfolio companies, with actual amounts, which may be significantly less, a function of market conditions at those times.

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Portfolio Company	IPO Date	Shares Owned(1) (in thousands)	Price Per Share (September 28, 2007)	USD Market Value(2) (dollars in thousands)
Gatehouse Media (NYSE: GHS)	10/06	22,050	$ 12.75	$ 281,138
GAGFAH (FSE: GFJ)	10/06	150,320	€ 13.80	2,959,563
Aircastle Limited (NYSE: AYR)	8/06	34,933	$ 33.42	1,167,456
Brookdale Senior Living (NYSE: BKD)	11/05	61,268	$ 39.81	2,439,095
Mapeley Limited (LSE: MAY)	6/05	15,631	£ 21.10	675,215
Eurocastle Investment Ltd (ENXT: ECT)	N/A	8,571	€ 24.27	296,794
Total				$ 7,819,261

Potential USD Proceeds	$ 7,819,261
Cost Basis (including debt) as of September 28, 2007	4,743,858
Total Potential Unrealized Gains(3)	$ 3,075,403
Incentive Income Paying %	94.52 %
Incentive Income Eligible Dollars	$ 2,906,822
Maximum Eligible Incentive Income %	20.00 %
Total Potential Incentive Income	$ 581,364
Fortress Retained % of Incentive Income(4)	64.41 %
Potential Incentive Income to Fortress Operating Group (unrealized public company surplus)(5)	$ 374,474
Potential Incentive Income to Fortress Operating Group adjusted for certain non-public investment write-downs	$ 361,829
Incentive Income Proceeds (year-to-date)(6)	$ 161,217

(1) Includes shares owned in hedge funds. (2) Foreign exchange rates are as of September 28, 2007. Calculated as the number of shares held multiplied by the closing stock price on the applicable stock exchange, without regard to liquidity discounts or other factors that could adversely impact the potential proceeds that might be realized upon disposition of these shares. (3) Assumes all incentive income thresholds specified in applicable fund agreements are met. (4) Represents percentage of incentive income not payable to employees. (5) Amounts ultimately received by us may vary significantly based on a variety of factors, including future public market values of these investments as well as the performance of investments that are not listed above held by the funds that hold the investments listed above. See Part II, Item 1A, ‘‘Risk Factors — Risks Related to Our Funds — 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.’’ (6) The amount of unrealized surplus was reduced by: (i) approximately $104.7 million in January 2007 as a result of the distribution of proceeds from a financing arrangement entered into by certain Fortress Funds which own shares of GAGFAH and (ii) approximately $56.5 million in July 2007 as a result of the sale of Crown Castle International shares.

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Market Considerations

Our revenues consist principally of (i) management fees which are based on the size of our funds, (ii) incentive income which is based on the performance of our funds and (iii) investment income from our investments in those funds. Our ability to grow our revenues depends on our ability to attract new capital and investors, which in turn depends on our ability to successfully invest our funds' capital. The primary market factors that impact this are:

- The strength of the alternative investment management industry, including the amount of capital invested and withdrawn from alternative investments. Our share of this capital is dependent on the strength of our performance relative to the performance of our competitors. The capital we attract is a driver of our AUM, as are our returns, which in turn drive the fees we earn.
- The strength and liquidity of the U.S. and relevant global equity markets generally, and the IPO market specifically, which affect our ability to increase the value of our equity positions in our private equity portfolio companies.
- The strength and liquidity of the U.S. and relevant global debt markets. 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 acquisitions. 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.
- Volatility within the markets. Volatility within the debt and equity markets, as well as within the commodity market to a limited extent, increases opportunities for investments within each of our segments, and directly impacts the performance of our liquid hedge funds.
- Other than in our liquid hedge funds, we benefit from stable interest rate and foreign currency exchange rate markets. The direction of the impact of changes in interest rates or foreign currency exchange rates on our liquid hedge funds is dependent on their expectations and the related direction of their investments at such time; therefore, historical trends in these markets are not necessarily indicative of future performance in these funds.

For the most part, we believe the trends in these factors have created a favorable investment environment for our funds.

- In recent years, the U.S. economy and capital markets have been robust, and we have successfully identified opportunities within other economies where trends have also been favorable for investment, such as Germany and the United Kingdom. Partially as a result of the globalization of our operations and the internationalization of our investments, we continue to identify what we believe to be attractive investment opportunities in new markets. Furthermore, the U.S. and international debt markets have expanded significantly in recent years as a result of the widespread growth in the securitization markets, although U.S. debt markets have recently experienced a tightening of available credit beginning in the third quarter of 2007.
- Institutions, high net worth individuals and other investors are increasing their allocations of capital to the alternative investment sector. As a leader in this sector based on the size, diversity and performance of our funds, we have been and continue to be able to attract a significant amount of new capital, at least in part as a result of this trend.
- Allocations of capital to the alternative investment sector are also dependent, in part, on the strength of the economy and the returns

available from other investments relative to returns from alternative investments. This, in turn, is also dependent on the interest rate and credit spread markets; as interest rates rise and/or spreads widen, returns available on other investments would tend to increase, which could slow capital flow to the alternative investment sector. In recent years, we have experienced relatively steady and historically low interest rates and tight credit spreads during the periods presented, which has been favorable

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to our business. However, market developments in the third quarter of 2007, which are discussed in more detail below, have caused credit spreads to widen. Credit spreads 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.

Historically, the trends discussed above have been generally favorable to our performance. No assurance can be given that future trends will not be disadvantageous to us.

While short-term disruptions in the markets, with respect to equity prices, interest rates, credit spreads or other market factors may adversely affect our existing positions, we believe such disruptions generally present significant new opportunities for investment, provided that we are able to finance investments on attractive terms.

In the first three quarters of 2007, the per share market prices of the investments held by our private equity funds in European public companies have decreased substantially. This, in turn, has contributed to a decrease in our public company surplus as described above under ‘‘—Public Company Surplus.’’ We believe these decreases are a result of a general downturn in demand for real estate company stocks rather than of a change in the strength of the underlying companies.

In recent months, disruption in the subprime mortgage lending sector has adversely affected the financial markets. In particular, the effects of the disruption have expanded beyond the subprime mortgage lending sector during the third quarter to affect the U.S. and other credit markets generally, primarily those markets tied to credit and corporate and real estate related fixed income securities. This disruption has negatively impacted the financial markets in which we operate in a number of ways:

- We have benefited in recent years from relatively tight interest rate spreads. Tight spreads have allowed us and the funds we manage to obtain financing for investments at attractive rates. Over the past several months, interest rate spreads have widened significantly. 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.
- Moreover, there currently appears to be less debt and equity capital available in the market relative to the levels available in recent years, which, coupled with recent additional margin collateral requirements imposed by lenders on some types of investments, has increased the importance of maintaining sufficient liquidity without relying upon additional infusions of capital from the debt and equity markets. Based on cash balances, committed financing and short-term operating cash flows, in the judgment of management we and the funds we manage have sufficient liquidity in the current market environment.
- A number of financial institutions have been required to provide additional margin collateral as collateral to support their obligations under their existing investments. With respect to certain assets within various Fortress Funds, the relevant funds have posted a substantial amount of margin collateral.

We do not currently know the full extent to which this recent disruption will affect us or the markets in which we operate. If the disruption continues, we and the funds we manage may experience further tightening of liquidity, reduced earnings and cash flow, impairment charges, as well as challenges in raising additional capital, obtaining investment financing and making investments on attractive terms. The direct effects of the subprime market disruption to date have been limited to: (i) a reduction in the value of two of our fund investments, by an aggregate of $13.4 million, and (ii) the discontinuance of incentive income from one of our funds for an indeterminate period of time.

These developments may produce a number of attractive investment opportunities in the future.

For a more detailed description of how economic and global financial market conditions can materially affect our financial performance and condition, see Part II, Item 1A, ‘‘Risk Factors — Risks Related to Our Funds — Difficult market conditions can adversely affect our funds in many ways, including by reducing the value or performance of the investments made by our funds and reducing the ability of our funds to raise or deploy capital, which could materially reduce our revenue and adversely affect results of operations.’’

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Results of Operations

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

Effective March 31, 2007, we deconsolidated our Fortress Funds and, subsequent to this transaction, our results of operations are presented on a deconsolidated basis. To provide better insight and understanding of our results of operations based on our current structure, and a better comparative basis, the following tables compare the pro forma results of our operations for the nine and three months ended September 30, 2007 and 2006 on a deconsolidated basis. The pro forma results will be the basis of the discussion in this section.

	Nine Months Ended September 30, 2007			Nine Months Ended September 30, 2006			
	Consolidated	Deconsolidation Adjustments	Pro Forma Deconsolidated	Consolidated	Deconsolidation Adjustments	Pro Forma Deconsolidated	Variance
Revenues							
Management fees from affiliates	$ 286,956	$ 53,072	$ 340,028	$ 106,883	$ 115,566	$ 222,449	$ 117,579
Incentive income from affiliates	283,879	211,682	495,561	94,391	6,999	101,390	394,171
Other revenues	51,866	(3,232)	48,634	53,743	(49,913)	3,830	44,804
Interest and dividend income – investment company holdings	309,030	(309,030)	—	778,451	(778,451)	—	—
	931,731	(47,508)	884,223	1,033,468	(705,799)	327,669	556,554
Expenses							
Interest expense	158,636	(132,620)	26,016	427,048	(400,383)	26,665	(649)
Compensation and benefits	507,003	(9,805)	497,198	269,278	(36,301)	232,977	264,221
Principals agreement compensation	612,981	—	612,981	—	—	—	612,981
General, administrative and other (including depreciation and amortization)	86,743	(22,024)	64,719	76,572	(37,354)	39,218	25,501
	1,365,363	(164,449)	1,200,914	772,898	(474,038)	298,860	902,054
Other Income (Loss)							
Gains (losses) – investment company holdings	(647,477)	647,477	—	2,681,754	(2,681,754)	—	—
Gains (losses) – other investments	(80,494)	—	(80,494)	94,873	4,258	99,131	(179,625)
Earnings (losses) from equity method investees	(23,289)	3,231	(20,058)	3,412	43,010	46,422	(66,480)
	(751,260)	650,708	(100,552)	2,780,039	(2,634,486)	145,553	(246,105)
Income (Loss) Before Deferred Incentive Income, Principals' and Others' Interests in Income of Consolidated Subsidiaries and Income Taxes	(1,184,892)	767,649	(417,243)	3,040,609	(2,866,247)	174,362	(591,605)
Deferred incentive income	307,034	(307,034)	—	(475,655)	475,655	—	—
Principals' and others' interests in loss (income) of consolidated subsidiaries	854,550	(460,615)	393,935	(2,403,346)	2,390,504	(12,842)	406,777
Income Before Income Taxes	(23,308)	—	(23,308)	161,608	(88)	161,520	(184,828)
Income tax expense	(7,237)	—	(7,237)	(8,898)	88	(8,810)	1,573
Net Income	$ (30,545)	$ —	$ (30,545)	$ 152,710	$ —	$ 152,710	$ (183,255)

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	Three Months Ended September 30, 2006	Three Months Ended September 30, 2007 Consolidated	Deconsolidation Adjustments	Pro Forma Deconsolidated	Variance
Revenues					
Management fees from affiliates	$ 124,991	$ 32,339	$ 41,983	$ 74,322	$ 50,669
Incentive income from affiliates	106,690	18,620	(404)	18,216	88,474
Other revenues	15,601	18,244	(16,455)	1,789	13,812
Interest and dividend income – investment company holdings	—	265,965	(265,965)	—	—
	247,282	335,168	(240,841)	94,327	152,955
Expenses					
Interest expense	7,285	162,163	(148,505)	13,658	(6,373)
Compensation and benefits	101,703	85,833	(17,506)	68,327	33,376
Principals agreement compensation	232,048	—	—	—	232,048
General, administrative and other (including depreciation and amortization)	19,642	23,101	(8,125)	14,976	4,666
	360,678	271,097	(174,136)	96,961	263,717
Other Income (Loss)					
Gains (losses) – investment company holdings	—	1,264,429	(1,264,429)	—	—
Gains (losses) – other investments	(58,198)	39,899	4,258	44,157	(102,355)
Earnings (losses) from equity method investees	(30,716)	992	28,400	29,392	(60,108)
	(88,914)	1,305,320	(1,231,771)	73,549	(162,463)
Income (Loss) Before Deferred Incentive Income, Principals’ and Others’ Interests in Income of Consolidated Subsidiaries and Income Taxes	(202,310)	1,369,391	(1,298,476)	70,915	(273,225)
Deferred incentive income	—	(214,248)	214,248	—	—
Principals’ and others’ interests in loss (income) of consolidated subsidiaries	152,534	(1,088,810)	1,084,162	(4,648)	157,182
Income (Loss) Before Income Taxes	(49,776)	66,333	(66)	66,267	(116,043)
Income tax benefit (expenses)	12,219	(1,628)	66	(1,562)	13,781
Net Income (Loss)	$ (37,557)	$ 64,705	$ —	$ 64,705	$ (102,262)

Factors Affecting Our Business

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

- changes in our AUM;
- level of performance of our funds;
- growth of our fund management and investment platform and our compensation structure to sustain that growth; and
- the income tax expense as a result of our reorganization which occurred in 2007.

Assets Under Management

We measure total AUM by reference to the assets we manage, including the capital we have the right to call from our investors due to their capital commitments. As a result of raising new funds with sizeable capital commitments for our private equity funds, raising capital for our Castles, securing capital commitments to our hedge funds and increases in the NAVs of our hedge funds from new investor capital and their retained profits, our AUM has increased significantly over the periods discussed.

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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 for the private equity funds, which in connection with 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.

Management Fees

Significant growth of our average fee paying AUM has had a positive effect on our revenues. As the AUM in our funds grew, so did the management fees we earned. 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.

Performance of Our Funds

Incentive Income

Incentive income is calculated as a percentage of profits earned by the Fortress Funds. Incentive income that is not subject to contingent repayment is recorded as earned, as incentive income from affiliates. Incentive income received from funds that continues to be subject to contingent repayment is deferred and recorded as a deferred incentive income liability until the related contingency is resolved.

The contingencies related to a portion of the incentive income we have received from two private equity Fortress Funds have been resolved. As our private equity funds continue to mature, the amount of incentive income recognized could continue to increase, subject to the performance of the funds and the resolution of the contingencies.

Fund Management and Investment Platform

In order to accommodate the increasing demands of our funds' rapidly growing investment portfolios, we have expanded our investment platforms, which are comprised primarily of our people, financial and operating systems and supporting infrastructure. Expansion of our investment platform 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 539 employees as of September 30, 2006 to 774 employees as of September 30, 2007. This resulted in increases in our compensation, office related and other personnel related expenses. In addition, in conjunction with and subsequent to our initial public offering, we have implemented an equity-based compensation plan described in Note 7 to Part I, Item 1, ''Financial Statements — Equity-Based Compensation'' as a means to provide an additional financial incentive to retain our existing and future employees.

Income Tax Expense

Prior to January 17, 2007, we, as a partnership, generally had not been subject to U.S. federal income tax but certain of our subsidiaries had been subject to the New York City unincorporated business tax (''UBT'') on their U.S. earnings based on a statutory rate of 4%. One of our subsidiaries was subject to U.S. federal corporate income taxes. Certain of our subsidiaries are subject to income tax of the foreign countries in which they conduct business.

In connection with the Nomura transaction and the initial public offering (see Note 1 to Part I, Item 1, ‘‘Financial Statements — Organization and Basis of Presentation’’), our operating entities were reorganized and a portion of our income is now subject to U.S. federal income taxes and taxed at the prevailing corporate tax rates.

The amount of income taxes that we may be required to pay could increase significantly if legislation recently introduced in the United States is passed in its proposed form. In June 2007,

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legislation was introduced in the U.S. Senate, which would tax us and other publicly traded partnerships as corporations, and similar legislation was introduced in the House. The proposed Senate legislation would not apply to us for five years, but the House legislation did not include any corresponding exemption period. In addition, legislation has been introduced in the House, and passed by the House Ways and Means Committee, that would have the effect of taxing income recognized from ‘‘carried interests’’ as ordinary income. If any of this legislation is enacted in its current or similar form, we would incur a material increase in our tax liability. For more information on the proposed legislation, see Part II, Item IA, ‘‘Risk Factors — Risks Related to Taxation — 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.’’

Revenues

Nine Months Ended September 30,	2007 (A)	2006 (A)	Variance
Management fees from affiliates	$ 340,028	$ 222,449	$ 117,579
Incentive income from affiliates	495,561	101,390	394,171
Other revenues	48,634	3,830	44,804
Total Revenue	$ 884,223	$ 327,669	$ 556,554

Three Months Ended September 30,	2007	2006 (A)	Variance
Management fees from affiliates	$ 124,991	$ 74,322	$ 50,669
Incentive income from affiliates	106,690	18,216	88,474
Other revenues	15,601	1,789	13,812
Total Revenue	$ 247,282	$ 94,327	$ 152,955

(A) Pro Forma results of our operations on a deconsolidated basis.

Nine months ended September 30

For the nine months ended September 30, 2007 compared with the nine months ended September 30, 2006, revenues increased as a result of the following:

Management fees from affiliates increased by $117.6 million primarily due to the net effect of increases in average management fee-paying AUM of $5.4 billion, $2.5 billion and $2.7 billion in our private equity funds, our liquid hedge funds and our hybrid hedge funds, respectively. The combined increase to average management fee-paying AUM drove $125.7 million of additional management fees. This increase was partially offset by a decrease of $16.7 million in management fees related to options that were received from our Castles as compensation for services performed in raising capital.

Incentive income from affiliates increased by $394.2 million primarily as a result of $309.3 million of incentive income recognized from our private equity funds for the nine months ended September 30, 2007, as contingencies for repayment had been resolved in certain funds allowing income recognition, compared to $8.6 million of incentive income accrued for one of our private equity funds for the nine months ended September 30, 2006, which was not subject to contingencies. Furthermore, our liquid hedge funds contributed an additional increase of $77.4 million in incentive income primarily from growth of average fee-paying AUM and higher returns.

Other revenues increased by $44.8 million primarily due to $32.3 million of additional expenses that were reimbursed to us by our funds, which are recorded gross on our statement of operations and interest income which increased by $9.1 million.

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Three months ended September 30

For the three months ended September 30, 2007 compared with the three months ended September 30, 2006, revenues increased as a result of the following:

Management fees from affiliates increased by $50.7 million primarily due to the net effect of increases in average management fee-paying AUM of $4.6 billion, $3.2 billion and $3.0 billion in our private equity funds, our liquid hedge funds and our hybrid hedge funds, respectively. The combined increase to average management fee-paying AUM drove $47.4 million of additional management fees.

Incentive income from affiliates increased by $88.5 million primarily as a result of $97.3 million of incentive income recognized from our private equity funds for the three months ended September 30, 2007, as contingencies for repayment had been resolved in certain funds allowing income recognition, compared to $3.2 million of incentive income accrued for one of our private equity funds for the three months ended September 30, 2006, which was not subject to contingencies. The net increase in incentive income from our private equity funds was partially offset by an $11.1 million reduction in the incentive income earned from our liquid hedge funds, due to lower returns.

Other revenues increased by $13.8 million primarily due to $11.9 million of additional expenses that were reimbursed to us by our funds, which are recorded gross on our statement of operations.

Expenses

In the analysis below, general, administrative and other expenses include depreciation and amortization.

Nine Months Ended September 30,	2007 (A)	2006 (A)	Variance
Interest expense	$ 26,016	$ 26,665	$ (649)
Compensation and benefits	497,198	232,977	264,221
Principals agreement compensation	612,981	—	612,981
General, administrative and other (including depreciation and amortization)	64,719	39,218	25,501
Total Expenses	$ 1,200,914	$ 298,860	$ 902,054

Three Months Ended September 30,	2007	2006 (A)	Variance
Interest expense	$ 7,285	$ 13,658	$ (6,373)
Compensation and benefits	101,703	68,327	33,376
Principals agreement compensation	232,048	—	232,048
General, administrative and other (including depreciation and amortization)	19,642	14,976	4,666
Total Expenses	$ 360,678	$ 96,961	$ 263,717

(A) Pro Forma results of our operations on a deconsolidated basis.

Nine months ended September 30

For the nine months ended September 30, 2007 compared with the nine months ended September 30, 2006, total expenses increased as a result of the following:

Interest expense decreased by $0.6 million primarily due to a reduction in our weighted average interest rate from 7.54% for the nine months ended September 30, 2006 to 6.85% for the nine months ended September 30, 2007, decreasing interest expense by $2.1 million. This decrease was partially offset by an increase in the weighted average debt outstanding under Fortress Operating Group's credit facility from $383.3 million for the nine months ended September 30, 2006 to $411.6 million for the nine months ended September 30, 2007, increasing interest expense by $1.6 million.

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Compensation and benefits increased by $264.2 million primarily due to profit-sharing compensation, equity-based compensation and growth in our employee population of $94.3 million, $91.4 million and $42.5 million, respectively. Profit-sharing compensation increased due largely to significant private equity realization events in the first and second quarters of 2007 and increased profit from our liquid hedge funds. The increase in equity-based compensation to employees was primarily related to the restricted stock units and LTIP award as described in Note 7 to Part I, Item 1, ‘‘Financial Statements — Equity-Based Compensation.’’ In addition, our average headcount for the nine months ended September 30, 2007 grew 45% compared to the nine months ended September 30, 2006.

Principals agreement compensation was $613.0 million for the nine months ended September 30, 2007. In connection with the initial public offering, the principals entered into an agreement among themselves, which provides that in the event a principal voluntarily terminates his employment with Fortress Operating Group for any reason prior to the fifth anniversary of the initial public offering, a portion of the equity interests held by that principal as of the completion of the initial public offering will be forfeited to the principals who are employed by Fortress Operating Group. As a result of this service requirement, the fair value of Fortress Operating Group units subject to the risk of forfeiture of $4,763.0 million will be charged to compensation expense on a straight-line basis over the five-year period. When Fortress records this non-cash expense, it records a corresponding increase in capital.

General, administrative and other expenses increased by $25.5 million, primarily as a result of increased office and administrative costs needed to support a significantly larger workforce, increased infrastructure demands, and professional fees and consulting fees relating to our transition to a public company.

Three months ended September 30

For the three months ended September 30, 2007 compared with the three months ended September 30, 2006, total expenses increased as a result of the following:

Interest expense decreased by $6.4 million primarily due to a reduction in our weighted average debt outstanding under Fortress Operating Group’s credit facility from $676.4 million for the three months ended September 30, 2006 to $364.1 million for the three months ended September 30, 2007, decreasing interest expense by $5.9 million.

Compensation and benefits increased by $33.4 million primarily due to equity-based compensation and growth in our employee population of $24.0 million and $16.1 million, respectively. The increase to equity-based compensation to employees was primarily related to the restricted stock units and LTIP award. Average headcount for the three months ended September 30, 2007 grew 44% compared to the three months ended September 30, 2006. These increases were partially offset by a decrease to profit sharing compensation due primarily to decreased profit from our hybrid and liquid hedge funds.

Principals agreement compensation was $232.0 million for the three months ended September 30, 2007. This expense is related to the Principals agreement as described above.

General, administrative and other expenses increased by $4.7 million, primarily as a result of increased office and administrative costs needed to support a significantly larger workforce, increased infrastructure demands, and shareholder expenses related to being a public company.

Future Compensation Expense

We will further recognize, in the future, non-cash compensation expense on our non-vested equity-based awards of $750.1 million with a weighted average recognition period of 5.27 years.

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Other Income

Nine Months Ended September 30,	2007 (A)	2006 (A)	Variance
Gains (losses) – other investments	$ (80,494)	$ 99,131	$ (179,625)
Earnings from equity method investees	(20,058)	46,422	(66,480)
Total Other Income	$ (100,552)	$ 145,553	$ (246,105)

Three Months Ended September 30,	2007	2006 (A)	Variance
Gains (losses) – other investments	$ (58,198)	$ 44,157	$ (102,355)
Earnings from equity method investees	(30,716)	29,392	(60,108)
Total Other Income	$ (88,914)	$ 73,549	$ (162,463)

(A) Pro Forma results of our operations on a deconsolidated basis.

Nine months ended September 30

For the nine months, the $246.1 million decrease in other income was primarily driven by: (i) a decrease in the value of our options in one of our Castles due to a decline in the relative performance of the underlying stock price of $116.9 million between the nine month periods, (ii) lower gains from our deferred fee arrangements as they were terminated prior to our initial public offering of $61.4 million and (iii) a decrease in the earnings on our investments in our funds of $66.5 million.

Three months ended September 30

For the three months, the $162.5 million decrease in other income was primarily driven by: (i) a decrease in the value of our options in one of our Castles due to a decline in the relative performance of the underlying stock price of $68.2 million between the three month periods, (ii) lower gains from our deferred fee arrangements as they were terminated prior to our initial public offering of $30.3 million, and (iii) a decrease in the earnings on our investments in our funds of $60.1 million.

Income Tax Benefit (Expense)

For the nine and three months ended September 30, 2007 compared with nine and three months ended September 30, 2006, income tax expense decreased by $1.6 million and $13.8 million, respectively. The primary reason for the decrease in tax expense is due to a decrease in income before income taxes. Our income tax status was affected by our reorganization (see Note 1 to Part I, Item 1, ‘‘Financial Statements — Organization and Basis of Presentation’’). Prior to our reorganization, we were generally not subject to U.S. federal income tax, with the exception of one subsidiary. Some subsidiaries were subject to New York City unincorporated business tax (‘‘UBT’’) at a statutory rate of 4%. Certain subsidiaries were subject to income tax in the foreign countries in which they conduct business. After our reorganization, FIG Corp., one of our wholly owned corporate subsidiaries, is taxed as a corporation for U.S. federal income tax purposes at a statutory rate of 35% on its share of income from Fortress Operating Group. Additionally, FIG Corp. is subject to state and local corporate income tax. Our effective tax rate after the reorganization is not comparable to our effective tax rate in 2006, before the reorganization.

Segment Analysis

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 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.

As mentioned above, results of operations for each of our segments are reflected on an unconsolidated basis, even for periods prior to the deconsolidation. Management also assesses our

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

Distributable earnings is GAAP net income adjusted for the following items:

i. adding a measure of incentive income which is subject to contingent repayment but for which collectibility is reasonably assured because management believes the likelihood of clawback is remote;

ii. modifying the timing of recognition of compensation expense related to employee profit sharing in incentive income to match the timing of the recognition of the related revenue, which is not matched under GAAP;

iii. recording income from equity method investees only to the extent it has been realized. While equity method income is a meaningful measure of the operating performance of equity method investees, it is not a measure of currently recognizable income for us as we are holding the interests in our funds for long-term investment purposes. Since any difference between our share of their GAAP income and the distributions we receive is unlikely to be realized until a liquidation transaction occurs, adjusting this income to delay recognition of our equity in undistributed earnings until it is realized is consistent with the principles of distributable earnings;

iv. only recording income from options received once they are exercised and the underlying shares sold, since the timing and amount of economic gain which may be realized from options held in equity method investees is highly uncertain and the GAAP valuation of such options is not a reliable measure of sustainable earnings; and

v. adding back our equity-based compensation because it does not require settlement by the future transfer or use of assets and therefore does not impact our analysis of earnings which will be available for potential distributions.

Distributable earnings for our existing businesses is equal to net income adjusted as follows:

• Incentive Income

(i) a. for Fortress Funds which are private equity funds, adding (a) incentive income paid (or declared as a distribution) to us, less an applicable reserve for potential future clawbacks if the likelihood of a clawback is deemed greater than remote (net of the reversal of any prior such reserves that are no longer deemed necessary), minus (b) incentive income recorded in accordance with GAAP, based on the accounting method described in ‘‘— Critical Accounting Policies — Revenue Recognition on Incentive Income,’’

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

• Other Income

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

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

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

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

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

• Expenses

(iv) adding or subtracting, as necessary, the employee profit sharing 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 (including the portion of related dividend equivalents recorded as compensation expense), restricted shares and the LTIP),

(vi) adding back compensation expense recorded in connection with the forfeiture arrangements entered into among the principals (see Note 7 to Part I, Item 1, ''Financial Statements — Equity-Based Compensation''),

(vii) adding the income (or subtracting the loss) allocable to the principals' interests attributable to Fortress Operating Group units, and

(viii) adding back income tax expense and any expense recorded in connection with the tax receivable agreement (see Note 5 to Part I, Item 1, ''Financial Statements — Income Taxes and Tax Related Payments'').

As a result of our reorganization on January 17, 2007 and our initial public offering on February 8, 2007, we have four additional reconciling items between our segment measure, distributable earnings, and GAAP net income. As reflected above, these adjustments relate to equity-based compensation expense of our employees and principals, interests in consolidated subsidiaries held by our principals, and income tax and related expense.

Private Equity Funds

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2007	2006	Variance	2007	2006	Variance
Management Fees	$ 97,749	$ 59,605	$ 38,144	$ 35,133	$ 21,958	$ 13,175
Incentive Income	273,890	96,176	177,714	83,592	—	83,592
Segment revenues – total	$ 371,639	$ 155,781	$ 215,858	$ 118,725	$ 21,958	$ 96,767
Pre-tax distributable earnings	$ 258,507	$ 112,433	$ 146,074	$ 82,303	$ 17,353	$ 64,950

Nine months ended September 30

Pre-tax distributable earnings increased by $146.1 million mainly due to:

– a $38.1 million increase in management fees. Management fees increased mainly due to $51.3 million of management fees generated by the creation of new private equity funds, most notably Fund V, Fund IV, Fortress Holiday Investment Fund (''FHIF''), Fortress Intrawest Coinvestment Fund (''FICO'') and Fund IV Coinvestment Fund (''Fund IV Co''). These increases to management fees were partially offset by a decrease of $5.3 million in management fees collected from Fund II as a result of distributions to investors, as well as decreases of $4.9 million and $2.8 million from Fund IV and Fund III, respectively, as a consequence of the creation of Fund V in May of 2007 (which caused the management fees from Fund IV to be based on invested capital rather than capital commitments), and the creation of Fund IV in March 2006 (which caused the management fees from Fund III to be based on invested capital rather than capital commitments);

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– a $113.5 million net increase in incentive income. Incentive income grew by $177.7 million partially offset by a corresponding increase in the employees' share of incentive income of $64.2 million reflected as profit sharing compensation expense. The increase of $177.7 million of incentive income was the result of proceeds distributed in relation to realization events by our private equity funds' investments in a residential housing company and Crown Castle International during the nine months ended September 30, 2007, net of proceeds distributed from realization events by our private equity funds' investments in Brookdale that occurred during the nine months ended September 30, 2006;

– a $13.0 million increase in operating expenses mainly driven by an increase in headcount; and

– a $6.4 million increase in investment income primarily as a result of our share in the realized gains from the aforementioned private equity funds' investments in a residential housing company and Crown Castle International during the nine months ended September 30, 2007, net of the gains related to Brookdale during the nine months ended September 30, 2006.

Three months ended September 30

Pre-tax distributable earnings increased by $65.0 million mainly due to:

– a $13.2 million increase in management fees. Management fees increased primarily due to a $22.6 million increase related to the creation of new private equity funds, most notably Fund V, FHIF, Fund IV Co, FICO and Fortress Florida East Coinvestment Fund (''Florida Co''). These increases to management fees were partially offset by a decrease of $4.9 million from Fund IV as a consequence of the creation of Fund V in May of 2007 (which caused the management fees from Fund IV to be based on invested capital rather than capital commitments), as well as a combined decrease of $3.1 million in management fees collected from Fund II, GAGACQ and Fortress Residential Investment Deutschland (''FRID'') as a result of distributions to investors;

– a $56.5 million net increase in incentive income. Incentive income grew by $83.6 million partially offset by a corresponding increase in the employees' share of incentive income of $27.1 million reflected as profit sharing compensation expense. The increase of $83.6 million of incentive income was the result of proceeds distributed in relation to the realization event with respect to Crown Castle International during the three months ended September 30, 2007, with no offsetting realization event during the three months ended September 30, 2006; and

– a $4.3 million increase in operating expenses mainly driven by an increase in headcount.

Liquid Hedge Funds

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2007	2006	Variance	2007	2006	Variance
Management Fees	$ 113,692	$ 63,919	$ 49,773	$ 44,351	$ 23,496	$ 20,855
Incentive Income	157,989	80,135	77,854	(210)	9,226	(9,436)
Segment revenues – total	$ 271,681	$ 144,054	$ 127,627	$ 44,141	$ 32,722	$ 11,419
Pre-tax distributable earnings	$ 131,637	$ 109,457	$ 22,180	$ 19,535	$ 31,831	$ (12,296)

Nine months ended September 30

Pre-tax distributable earnings increased by $22.2 million mainly due to:

– a $43.3 million net increase in management fees. Management fees increased by $49.8 million partially offset by a corresponding increase in the employees’ share of management fees of $6.5 million. The net increase was primarily a result of the growth in average management fee paying AUM and an increase in the average management fee percentage earned, which drove $39.0 million and $8.9 million of additional management fees, respectively;

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– a $49.9 million net increase to incentive income. Incentive income increased by $77.9 million partially offset by a corresponding increase in the employees’ share of incentive income of $28.0 million, reflected as profit sharing compensation expense. The $77.9 million increase in incentive income is primarily attributable to an increase in average AUM eligible for incentive income and higher returns, which contributed increases of $48.2 million and $28.5 million, respectively;

– a $21.6 million increase in operating expenses mainly due to an increase in headcount; and

– a $49.4 million decrease in investment income. This decline is mainly attributable to the distribution of previously earned fees which had generated $52.4 million of income for the nine months ended September 30, 2006, compared to $2.9 million for the nine months ended September 30, 2007.

Three months ended September 30

Pre-tax distributable earnings decreased by $12.3 million mainly due to:

– an $18.1 million net increase to management fees. Management fees increased by $20.9 million partially offset by a corresponding increase in the employees’ share of management fees of $2.8 million. This increase was mainly the result of the growth in average management fee paying AUM, which resulted in an increase in management fees of $17.1 million;

– a $3.7 million net increase in incentive income. Incentive income decreased by $9.4 million offset by a corresponding decrease in the employees’ share of incentive income of $13.1 million, reflected as profit sharing compensation expense. The $9.4 million decrease in incentive income is attributable to a $17.8 million decrease in incentive income due to lower performance of one of the funds, partially offset by an increase in average AUM eligible for incentive income, which contributed an increase of $6.7 million. The corresponding $13.1 million decrease in profit sharing compensation expense was higher than the base incentive income decrease of $9.4 million due to a reduction in profit sharing for certain individuals’ trading performance during the three months ended September 30, 2007;

– a $5.7 million increase in operating expenses mainly driven by an increase in headcount; and

– a $28.5 million decrease in investment income. This decrease is mainly due to income from the distribution of previously earned fees which had generated $24.3 million of income for the three months ended September 30, 2006, and no income for the three months ended September 30, 2007.

Hybrid Hedge Funds

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2007	2006	Variance	2007	2006	Variance
Management Fees	$ 94,096	$ 57,240	$ 36,856	$ 33,376	$ 21,208	$ 12,168
Incentive Income	93,832	86,644	7,188	9,463	33,137	(23,674)
Segment revenues – total	$ 187,928	$ 143,884	$ 44,044	$ 42,839	$ 54,345	$ (11,506)
Pre-tax distributable earnings	$ 81,710	$ 66,236	$ 15,474	$ 9,994	$ 28,148	$ (18,154)

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Nine months ended September 30

Pre-tax distributable earnings increased by $15.5 million mainly due to:

– a $36.9 million increase in management fees. The increase to management fees was mainly a result of growth in average management fee paying AUM, which drove a $32.3 million increase. In addition, Fortress Partners Fund generated $3.5 million of management fees for the six months ended June 30, 2007 which was incremental to the six months ended June 30, 2006, as the fund was not created until July 2006;

– an $8.1 million net increase in incentive income. Incentive income increased by $7.2 million and the employees' share of incentive income, reflected as profit sharing compensation expense, decreased by $0.9 million. The $7.2 million increase in incentive income was mainly attributable to an increase in average AUM eligible for incentive, which drove a $38.0 million increase in incentive income. This increase was partially offset by a decline in the return of our hybrid hedge funds, including special investments, which generated a decrease of $30.2 million;

– a $42.5 million increase in operating expenses primarily related to an increase in headcount; and

– a $13.0 million increase in investment income. This increase was mainly due to investment income generated by the creation of Fortress Partners Fund in July 2006 and the performance of our investments of $18.6 million and $3.4 million, respectively. This increase in investment income was partially offset by an $11.9 million decrease in income from the distribution of previously earned fees.

Three months ended September 30

Pre-tax distributable earnings decreased by $18.2 million mainly due to:

– a $12.2 million increase in management fees. The increase to management fees was mainly a result of growth in average management fee paying AUM, which drove a $12.4 million increase;

– a $10.5 million net decrease in incentive income. Incentive income decreased by $23.7 million and the employees' share of incentive income, reflected as profit sharing compensation expense, decreased by $13.2 million. The $23.7 million decrease in incentive income was mainly attributable to a decline in the return of our hybrid hedge funds, including special investments, which generated a decrease of $35.3 million in incentive income. This $35.3 million decrease was partially offset by growth in average AUM eligible for incentive income which generated $12.1 million of additional incentive income;

– a $17.2 million increase in operating expenses primarily related to an increase in headcount; and

– a $2.6 million decrease in investment income. This decrease is mainly due to income from the distribution of previously earned fees which had generated $6.0 million of income for the three months ended September 30, 2006, and no income for the three months ended September 30, 2007. This decrease was partially offset by a decrease in the employees portion of the income from the distribution of previously earned fees.

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Publicly Traded Alternative Investment Vehicles (‘‘Castles’’)

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2007	2006	Variance	2007	2006	Variance
Management Fees	$ 34,877	$ 23,116	$ 11,761	$ 12,131	$ 8,106	$ 4,025
Incentive Income	18,596	11,567	7,029	691	5,098	(4,407)
Segment revenues – total	$ 53,473	$ 34,683	$ 18,790	$ 12,822	$ 13,204	$ (382)
Pre-tax distributable earnings	$ 25,315	$ 8,966	$ 16,349	$ 4,609	$ 6,894	$ (2,285)

Nine months ended September 30

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

– a $10.2 million net increase in management fees. Management fees increased by $11.8 million primarily as a result of the growth of average management fee paying AUM, which resulted in an $11.0 million increase. The $11.8 million increase was partially offset by a $1.3 million increase in the employees’ share of operating income, reflected as compensation expense, and a $0.3 million increase in operating expenses, primarily due to increased headcount; and

– a $7.0 million increase in incentive income primarily due to an increase of $4.8 million of incentive income because of increased equity that is eligible for incentive income, which grew primarily as a result of capital raises by Eurocastle. In addition, $1.7 million of increased incentive income was due to higher FFO in excess of certain performance hurdles for Eurocastle;

– a $0.9 million decrease in investment income. The primary driver of this decrease is a change in the loss from foreign currency derivatives related to Eurocastle and Northcastle of $1.4 million, partially offset by a $0.5 million increase in the dividend income received on our shares held in Eurocastle and Newcastle.

Three months ended September 30

Pre-tax distributable earnings decreased by $2.3 million primarily due to:

– a $5.5 million net increase in management fees. Management fees increased by $4.0 million as a result of the growth of average management fee paying AUM. In addition, operating expenses and employees’ share of operating income, reflected as compensation expense, decreased $1.3 million and $0.2 million, respectively; and

– a $4.4 million decrease in incentive income primarily due to a decrease of $7.0 million as a result of lower FFO in excess of certain performance hurdles. This decrease was partially offset by an increase of $2.5 million of incentive income because of increased equity that is eligible for incentive income, which primarily grew as a result of capital raises by Eurocastle;

– a $3.4 million decrease in investment income. The primary driver of this decrease is a change in the loss from foreign currency derivatives related to Eurocastle and Northcastle of $3.7 million, partially offset by a $0.3 million increase in the dividend income received on our shares held in Eurocastle and Newcastle.

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Unallocated

	Nine Months Ended September 30,			Three Months Ended September 30,		
	2007	2006	Variance	2007	2006	Variance
Management Fees	$ —	$ —	$ —	$ —	$ —	$ —
Incentive Income	—	—	—	—	—	—
Segment revenues – total	$ —	$ —	$ —	$ —	$ —	$ —
Pre-tax distributable earnings	$ (23,580)	$ (37,919)	$ 14,339	$ (5,689)	$ (17,212)	$ 11,523

Nine months ended September 30

Pre-tax distributable earnings increased by $14.3 million. The increase was primarily driven by an $11.4 million increase in investment income, primarily as a result of interest earned on cash, in part on cash received from our initial public offering. In addition, operating expenses decreased by $2.3 million. Furthermore, interest expense decreased by $0.6 million mainly driven by a decrease to the weighted average interest rate from 7.54% for the nine months ended September 30, 2006 to 6.85% for the nine months ended September 30, 2007, decreasing interest expense by $2.1 million, offset partially by an increase in the weighted average debt outstanding from $383.3 million for the nine months ended September 30, 2006 to $411.6 million for the nine months ended September 30, 2007, which increased interest expense by $1.6 million.

Three months ended September 30

Pre-tax distributable earnings increased by $11.5 million. The increase was primarily driven by a decrease in interest expense of $6.4 million mainly driven by a decrease to the weighted average debt outstanding from $676.4 million for the three months ended September 30, 2006 to $364.1 million for the three months ended September 30, 2007, which decreased interest expense by $5.9 million, and a decrease in the weighted average interest rate from 7.57% for the three months ended September 30, 2006 to 6.57% for the three months ended September 30, 2007, decreasing interest expense by $0.9 million. Furthermore, an additional $4.7 million of investment income was earned from interest earned on cash.

Sensitivity

Investments held by the Fortress Funds are sensitive to changes in our valuation assumptions and estimates as well as fluctuations in fair value. A 10% change in the fair value of the net investments held by all of our funds (other than a permanent impairment) would have the following effects on our segment revenues:

Segment Basis	Management Fees	Incentive Income	Investment Income (Unrealized Gains and Losses)
Private equity funds	None (A)	None (B)	None
Hedge funds (hybrid and liquid)	10% annual change in management fees from these funds, subsequent to the change in value.	Generally, a 10% immediate change in incentive income from these funds. Since the incentive income is generally equal to 20% – 25% of fund returns, the dollar effect would be 2.0 – 2.5% (20% – 25% of 10%) of the dollar change in values.	Generally, a 10% immediate change in investment income. Since we generally have a 1% – 5% investment in

these funds, the dollar effect would be 0.1% – 0.5% (1% – 5% of 10%) of the dollar change in values (C). Castles
None None None
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(A) For funds formed after March 2006 which are no longer in the commitment period, a 10% change in the fair value of their $700.4 million of net investments held in publicly traded entities would affect management fees by 10% of the management fees based on the value of such investments on a prospective basis, subsequent to the change in value. (B) Although a change in fair value could indirectly impact our conclusion regarding a potential reserve. (C) We have a 18.3% interest in one hybrid hedge fund in which we had invested $215.5 million as of September 30, 2007.

A 10% increase or decrease in the fair value of net investments held by all of our funds as of September 30, 2007 would have increased or decreased our segment incentive income by $228.1 million or ($93.8 million), respectively, and impacted investment income by $45.4 million.

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 as a result of our reorganization (see Note 1 to Part I, Item 1, ‘‘Financial Statements — Organization and Basis of Presentation’’). In addition, we will require cash to meet our intended distribution policy. 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 issuance of debt and equity securities, as well as the investment returns on our principal investments in these funds.

The timing of receipt of cash flows from operating activities is in large part dependent on the timing of distributions from our private equity funds and redemptions from our hedge funds, which are subject to restrictions and to management’s judgment regarding the optimal timing of the monetization of underlying investments. The timing of capital requirements to cover fund commitments is subject to management’s judgment regarding the acquisition of new investments within the funds, as well as the liquidity requirements of the 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.

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. 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.

On February 8, 2007, we completed an initial public offering of 39,428,900 of our Class A shares, including the underwriters’ over allotment option, for net proceeds of approximately $652.7 million. We contributed the net proceeds from the offering to Fortress Operating Group in exchange for 39,428,900 limited partnership units. As of September 30, 2007, Fortress Operating Group had applied those proceeds in accordance with its IPO registration statement as follows: (a) to pay $250 million then outstanding under its term loan facility, as required by the credit agreement, (b) to pay $85 million then outstanding under its revolving credit facility, (c) to fund $169 million of commitments to private equity funds, and (d) to fund $149 million of general business purposes, including additional investments.

In addition, in connection with the Nomura transaction and the initial public offering (see Note 1 to Part I, Item 1, ‘‘Financial Statements — Organization and Basis of Presentation’’), we reorganized.

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We established a publicly traded partnership and also established a wholly owned corporate subsidiary. 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.

We expect that our cash on hand and our cash flows from operating activities will satisfy our liquidity needs with respect to current commitments relating to investments and with respect to our debt obligations over the next twelve months. We expect to meet our long-term liquidity requirements, including the repayment of our debt obligations and any new commitments or increases in our commitments, relating to principal investments, through the generation of operating income, additional borrowings and potential equity offerings.

As of September 30, 2007, our material cash commitments and contractual cash requirements were related to our distributions, capital commitments to our funds, lease obligations and debt obligations.

Dividends / Distributions

On September 15, 2007, we declared a third quarter cash dividend of $0.225 per Class A share. The dividend was paid on October 12, 2007 to holders of record of our Class A shares on September 28, 2007. The aggregate amount of this dividend payment was $21.3 million. In connection with this dividend, a distribution of $70.2 million was declared from Fortress Operating Group to the principals and dividend equivalent payments of $5.4 million were made to holders of restricted Class A share units.

On June 15, 2007, we declared a second quarter cash dividend of $0.225 per Class A share. The dividend was paid on July 13, 2007 to holders of record of our Class A shares on June 29, 2007. The aggregate amount of this dividend payment was $21.3 million. In connection with this dividend, a distribution of $70.2 million was declared from Fortress Operating Group to the principals and dividend equivalent payments of $5.4 million were made to holders of restricted Class A share units.

On March 20, 2007, we declared a partial first quarter cash dividend of $0.1225 per Class A share for the period beginning February 8, 2007 (the pricing date of our initial public offering) through March 31, 2007. The dividend was paid on April 13, 2007 to holders of record of our Class A shares on March 30, 2007. The aggregate amount of this dividend payment was $11.6 million. In connection with this dividend, a distribution of $39.4 million was declared from Fortress Operating Group to the principals and dividend equivalent payments of $3.0 million were made to holders of restricted Class A share units.

Capital Commitments

We determine whether to make capital commitments to our private equity 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.

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Our capital commitments to our funds with outstanding commitments as of September 30, 2007 consisted of the following:

Private Equity Funds	Outstanding Commitment
Fund II	$ 1,992
Fund III	3,073
Fund III Coinvestment	10
Fund IV	20,207
Fund IV Coinvestment	18
Fund V	50,877
Fund V Coinvestment	40
Fortress Residential Investment Deutschland	2,632
Fortress Intrawest Coinvestment Fund	12
Fortress Holiday Investment Fund	8,474
Fortress Florida East Coinvestment Fund	48,651
Long Dated Value Fund I	104
Long Dated Value Fund II	2,659
Long Dated Value Fund III	581
Real Assets Fund	41,750
Total	$ 181,080

Lease Obligations

Minimum future rental payments under our operating leases are as follows:

October 1 to December 31, 2007	$ 3,414
2008	13,676
2009	12,909
2010	12,455
2011	9,346
2012	6,206
Thereafter	22,857
Total	$ 80,863

Debt Obligations

As of September 30, 2007, our debt obligations consisted of the amount outstanding under our credit agreement, as described below.

In 2002, we borrowed $2.9 million collateralized by our interest in an aircraft (the ‘‘aircraft loan’’). This loan bore interest at LIBOR plus 2.25%. We had hedged our exposure to the risk of changes in market interest rates with respect to this loan by entering into an interest rate swap, which fixed the effective interest rate on this loan at approximately 6.80% through maturity. In June 2007, we repaid all amounts outstanding under the aircraft loan and terminated the related interest rate swap.

In March 2005, we entered into a new $175 million credit agreement (the ‘‘2005 Credit Agreement’’), which, among other things, refinanced a $98.5 million credit facility. The 2005 Credit Agreement bore interest at LIBOR plus 2.75% and was subject to unused commitment fees of 0.375% per annum and letter of credit fees of 2.75% per annum. In December 2005, the agreement was amended to increase the available line by $70.1 million.

In June 2006, we entered into a new $750 million credit agreement (the ‘‘2006 Credit Agreement’’). Borrowings under the 2006 Credit Agreement bore interest at LIBOR plus 2.00%, with

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the agreement being subject to unused commitment fees of 0.375% per annum. The purpose of the 2006 Credit Agreement was to refinance the 2005 Credit Agreement described above, to make funds available for investments in the various existing and new Fortress Funds, and to make a one-time $250 million distribution of capital to our principals. In connection with the repayment of the prior credit facility, deferred loan costs of $3.1 million were written off to interest expense in June 2006.

As a result of our initial public offering, we became subject to a reduced unused commitment fee of 0.25% and a letter of credit fee of 1.50% and borrowings under the 2006 Credit Agreement accrued interest at a rate equal to (i) with respect to LIBOR loans, LIBOR plus 1.50% and (ii) with respect to base rate loans, the base rate, as defined in the credit agreement, plus 0.50%. $250 million of the term loan and $85 million of the revolving credit facility under the 2006 Credit Agreement were repaid with proceeds received from our initial public offering. In connection with the partial pay-down of the existing credit facility, deferred loan costs of $2.0 million were written off to interest expense in February 2007.

In May 2007, we entered into a new $1 billion credit agreement (the ''2007 Credit Agreement'') in order to refinance the 2006 Credit Agreement described above, reduce the amount of interest and other fees payable under our credit facilities and increase the amount of funds available for investments. The 2007 Credit Agreement is collateralized by substantially all the Fortress Operating Group assets as well Fortress Operating Group's rights to fees from the Fortress Funds and its equity interests therein.

The credit facilities available under the 2007 Credit Agreement include a $200 million revolving credit facility (including a $25 million letter of credit subfacility), a $350 million term loan facility and a $450 million delayed term loan facility. Borrowings and letters of credit issued under the 2007 Credit Agreement bear interest at a rate equal to (i) with respect to LIBOR loans, LIBOR plus 1.20%, or (ii) with respect to base rate loans, the base rate, as defined in the agreement, plus 0.20%, with such rates subject to reduction upon the receipt of specified debt ratings by S&P and Moody's. In addition, we will be required to pay a commitment fee of 0.375% per annum on the unused portion of amounts available under our revolving credit facility and our delayed term loan facility (provided that the unused commitment fee for the delayed term loan facility will be 0.175% per annum for the first 135 days after closing).

The following table presents summarized information regarding our debt obligations:

		Face Amount and Carrying Value		Final Stated Maturity	September 30, 2007	
	Debt Obligation	September 30, 2007	December 31, 2006		Weighted Average Funding Cost(2)	Weighted Average Maturity (Years)
Credit Agreement	Revolving debt(1)	$ 75,000	$ 85,000	May 2012	9.49 %	4.61
	Term loan	350,000	600,000	May 2012	7.20 %	4.61
	Delayed term loan(1)	—	—	May 2012	0.00 %	—
	Aircraft loan	—	2,153	Repaid	0.00 %	—
	Total	$ 425,000	$ 687,153		7.60 %	4.61
Consolidated Fortress Fund debt						

2,619,456	Total	$ 3,306,609

(1) Approximately $114.5 million and $450.0 million were undrawn and available on the revolving debt and delayed term loan, respectively, as of September 30, 2007, including a $25.0 million letter of credit subfacility of which $10.5 million was utilized. The delayed term loan must be drawn by February 2008 or its availability expires.

(2) Includes amortization of deferred financing costs.

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Covenants

Fortress Operating Group is required to prepay the 2007 Credit Agreement upon the occurrence of certain events, including asset sales and other dispositions.

The 2007 Credit Agreement includes customary covenants. We are in compliance with all of the covenants as of September 30, 2007. Among other things, the borrowers are prohibited from incurring additional indebtedness or further encumbering their assets, subject to certain exceptions. In addition, Fortress Operating Group must not:

- Permit the assets under management subject to management fees to be less than $18 billion during fiscal year 2007, plus an additional $500 million during each subsequent fiscal year;
- Permit the EBITDA, as defined in the 2007 Credit Agreement, generated during the previous twelve months to be less than (i) $375 million as of each of June 30, 2007, or September 30, 2007, (ii) $400 million as of the end of each of December 31, 2007, March 31, 2008, June 30, 2008 or September 30, 2008, or (iii) $500 million as of the end of each subsequent fiscal quarter;
- Permit the aggregate value of investments held to be less than the sum of (i) $550 million plus (ii) the aggregate outstanding amount of any delayed draw term loans plus (iii) an additional $50 million as of March 31 of each subsequent fiscal year (together, the ‘‘Required Investment Assets’’);
- Permit the aggregate value of Fortress Fund Investments (generally defined in the 2007 Credit Agreement as the stock of Newcastle, Eurocastle and any other publicly traded company pledged as collateral (and any options in respect of such stock), and Fortress Operating Group’s interest in the Fortress private equity funds and hedge funds and certain other investment funds) to be less than 40% of the Required Investment Assets;
- Permit the aggregate value of the sum of (i) the Fortress Fund Investments plus (ii) certain investments in co-investment funds to be less than 60% of the Required Investment Assets (with no single co-investment fund investment exceeding $75 million).

In addition, under the 2007 Credit Agreement, Fortress Operating Group is permitted to make cash distributions (i) in order for our shareholders to pay their taxes, and (ii) other cash distributions subject to the following restrictions: (a) no event of default exists immediately prior to or subsequent to the distribution, and (b) the distribution would not exceed cumulative free cash flow. Free cash flow, as defined in our 2007 Credit Agreement, is calculated on a cumulative basis as $163 million plus EBITDA earned since March 31, 2007, minus interest paid, capital expenditures made and distributions made since March 31, 2007.

The events of default described under the 2007 Credit Agreement are typical of such agreements and include payment defaults, failure to comply with credit agreement covenants, cross-defaults to material indebtedness, bankruptcy and insolvency, change of control, and adverse events (as defined in the Credit Agreement) with respect to our material funds.

This summary is qualified by reference to our 2007 Credit Agreement, a copy of which has been filed with the SEC as an exhibit to our current report on Form 8-K dated May 14, 2007.

Cash Flows

Our historical consolidated statements of cash flows reflect the cash flows of Fortress Operating Group as well as those of our consolidated Fortress Funds (through their deconsolidation on March 31, 2007), which were all investment companies, but included Northcastle, which was not an investment company, for the period ended September 30, 2006.

The consolidated Fortress Funds, on a gross basis, are much larger than Fortress Operating Group and therefore substantially all of the gross cash flows reflected in our statement of cash flows, through their deconsolidation on March 31, 2007, relate to their activities. The primary cash flow activities of Fortress Operating Group are: (i) generating cash flow from operations, (ii) making

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investments in Fortress Funds (these cash flows are eliminated in consolidation through March 31, 2007), (iii) meeting financing needs through our credit agreement, and (iv) distributing cash flow to equity holders. The primary cash flow activities of the Fortress Funds which were consolidated through March 31, 2007 were: (i) raising capital from their investors, which have historically been reflected as Principals' and others' interests in equity of consolidated subsidiaries in our financial statements, (ii) using this capital to make investments, (iii) financing certain investments with debt, (iv) generating cash flow from operations through the realization of investments, and (v) distributing cash flow to investors.

As described above in ''— Results of Operations,'' our AUM, which are primarily representative of the net assets within the Fortress Funds, have grown significantly throughout the periods reflected in our financial statements included in this Quarterly Report on Form 10-Q. This growth is a result of these funds raising and investing capital, and generating gains from investments, during these periods. Their cash flows, which are reflected in our statement of cash flows for consolidated Fortress Funds through March 31, 2007, have increased substantially as a result of this growth. This growth is the primary cause of increases in the gross cash flows reflected in our statements of cash flows.

Our dividend policy has certain risks and limitations, particularly with respect to liquidity. Although we expect to pay dividends in accordance with our 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. To the extent we do not have cash on hand sufficient to pay dividends, we may have to borrow funds to pay dividends, or we may determine not to borrow funds to pay dividends. 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.

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.

Operating Activities

Our net cash flow (used in) operating activities was ($945.2) million and ($3,457.6) million during the nine months ended September 30, 2007 and 2006, respectively. In addition to cash from Fortress's operations, these amounts included net purchases of investments by consolidated Fortress Funds (included in our statements of cash flows through their deconsolidation on March 31, 2007), which are investment companies, after proceeds from sales of investments, of ($1,707.1) million and ($3,231.6) million during those periods, respectively, which are reflected as operating activities pursuant to investment company accounting.

The consolidation of the Fortress Funds and the voluntary deferral of certain fees (which are no longer being deferred) caused our historical cash flows from operations to be negative. We do not expect this to be the case subsequent to the discontinuation of the voluntary deferral of fees and the deconsolidation of the Fortress Funds, both of which have occurred.

Investing Activities

Our net cash flow (used in) investing activities was ($432.5) million and ($42.7) million during the nine months ended September 30, 2007 and 2006, respectively. Our investing activities primarily included: (i) purchases, net of proceeds from sales of investments, of loan and security investments by one of our consolidated Fortress Funds (included in our statements of cash flows through its deconsolidation on March 31, 2007), which is not an investment company, of ($31.2) million during the 2006 period, (ii) contributions to equity method investees of ($560.3) million and ($0.8) million during those periods, respectively, (iii) distributions of capital from equity method investees of $115.2 million and $0.6 million during the periods, respectively, (iv) proceeds from sale of equity method investments

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of $29.1 million for the period ending September 30, 2007, and (v) purchases of fixed assets, net of proceeds from the disposal of fixed assets of ($6.4) million and ($10.8) million during those periods, respectively.

Financing Activities

On December 18, 2006, the principals entered into a securities purchase agreement with Nomura, pursuant to which Nomura acquired a then 15% indirect stake in Fortress Operating Group for $888 million, all of the proceeds of which were paid to the principals. On January 17, 2007, Nomura completed the transaction by purchasing 55,071,450 Class A shares for $888 million and we, in turn, purchased 55,071,450 Fortress Operating Group limited partnership units, which then represented 15% of Fortress Operating Group's economic interests, and the sole general partner interest, from the principals for $888 million.

In addition, on February 8, 2007, we completed an initial public offering of 39,428,900 of our Class A shares, for net proceeds of approximately $652.7 million.

Our net cash flow provided by financing activities was $1,486.1 million and $3,495.7 million during the nine months ended September 30, 2007 and 2006, respectively. Our financing activities included (i) contributions made by, net of distributions made to, the investors in our consolidated Fortress Funds (included in our statements of cash flows through their deconsolidation on March 31, 2007), historically reflected as others' interests in consolidated subsidiaries, of $1,514.4 million and $3,006.4 million during those periods, respectively, (ii) distributions made to principals of ($620.0) million and ($350.1) million during those periods, respectively, and (iii) our net borrowing and repayment activity.

Critical Accounting Policies

Consolidation

Historically, we consolidated certain of the Fortress Funds as a result of owning a substantive, controlling general partner interest in these entities, or, for variable interest entities, by being their primary beneficiary. We had operational discretion and control of these funds combined with the limited partners' limited substantive rights to impact their ongoing governance and operating activities which resulted in their being consolidated by us; however, in no case were we the majority equity holder. In connection with the initial public offering, Fortress granted rights effective March 31, 2007 to the investors in the consolidated Fortress Funds to provide a simple majority of the unrelated limited partners with the ability to liquidate the funds without cause or to otherwise have the ability to exert control over the funds, resulting in the deconsolidation of these funds for financial reporting purposes.

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, probability weighting of subjectively determined cash flow scenarios, and other estimates based on the assumptions of management.

Fortress Operating Group's combined financial statements reflected the assets, liabilities, revenues, expenses and cash flows of the consolidated Fortress Funds on a gross basis through March 31, 2007. Our investors' interests in these funds, which are the majority ownership interests, have historically been reflected as others' interests in consolidated subsidiaries in these financial statements. The management fees and incentive income earned by Fortress from the consolidated Fortress Funds were eliminated in consolidation; however, our allocated share of the net income from these funds was increased by the amount of these eliminated fees. Accordingly, the consolidation of these Fortress Funds had no net effect on our net earnings from the Fortress Funds and the deconsolidation of the funds likewise had no net effect on Fortress's earnings. The deconsolidation has

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had the effect of restoring the presentation of management fees and incentive income from the Fortress Funds that had been eliminated in consolidation.

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 we manage is subject to contingent repayment (or clawback) and may be paid to us as particular investments made by the funds are realized. If, however, upon liquidation of a fund the aggregate amount paid to us as incentive income exceeds the amount actually due to us based upon the aggregate performance of the fund, the excess is required to be returned by us (i.e. ‘‘clawed back’’) to that fund. We have elected to adopt the preferred method of recording incentive income subject to contingencies, Method 1 of Emerging Issues Task Force Topic D-96 ‘‘Accounting for Management Fees Based on a Formula.’’ 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, each of which has a limited life, would be recognized upon the termination of a private equity fund, or when distributions from a fund exceed the point at which a clawback of a portion or all of the historic incentive income distributions could no longer occur. Recognition of incentive income allocated to us prior to that date is deferred and recorded as a deferred incentive income liability. For GAAP purposes, the determination of when incentive income is recognized as income is formulaic in nature, resulting directly from each fund’s governing documents.

Profit Sharing Arrangements

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

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

For profit sharing plans related to private equity funds, 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.

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.

As of September 30, 2007, Fortress has recognized and paid compensation expense under its employee profit sharing arrangements in connection with the $444.7 million of distributed incentive income from private equity funds. If the $688.4 million of undistributed incentive income from private equity funds was realized, Fortress would recognize an additional $213.3 million of compensation expense.

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Valuation of Investments

As a result of the deconsolidation described above, our investments in the Fortress Funds are accounted for under the equity method subsequent to March 31, 2007. The Fortress Funds themselves apply specialized accounting principles specified by the AICPA Audit and Accounting Guide — Investment Companies. As such, our results are based on the reported fair value of 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 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. The values arrived at may be adjusted if, when estimating the value, it is determined that a more accurate value can be obtained from recent trading activity or by incorporating other relevant information that may not have been reflected in pricing obtained from the models. Fair values obtained from external sources are rarely (less than 1% of our value estimates) adjusted in this manner. Significant judgment and estimation goes into the assumptions which drive 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 as of September 30, 2007.

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 never based a valuation of a private security 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 a measure of valuation for such private security investment.

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

If the fair value of private security investments held by our private equity funds cannot be valued by reference to a public or private market transaction, then the primary analytical methods used to estimate the fair value of such private securities are the discounted cash flow method, by reference to performance statistics of similar public companies (for example, EBITDA multiples) or the use of

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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 are made up almost entirely of (i) interest rate swaps and swaptions, equity swaps and foreign exchange swaps which are valued by the independent fund administrator using models with significant observable market parameters, and (ii) funds managed by third parties for which we receive value information from the fund managers. 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.

Hybrid Hedge Funds

In our hybrid hedge funds, investments are valued using quoted market prices, to the extent available. Independent valuation agents are used by our hybrid 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.

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

Another method used to value loans that may not be repaid in full is to value the total amount of assets of the borrower that might be sold to raise proceeds to repay the loan 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, 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 securities.

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Sensitivity

GAAP Basis Management Fees Incentive
Income Earnings from Equity Method
Investees Private equity
funds None (A) None (B) Generally, a 10% immediate change in earnings from equity method investees. Since we generally have a 1% – 5% investment in these funds, the dollar effect would be 0.1% – 0.5% (1% – 5% of 10%) of the dollar change in values. (C) Hybrid & Liquid Hedge funds 10% annual change in management fees from these funds, subsequent to the change in value. Generally, a 10% immediate change in incentive income from these funds. Since the incentive income is generally equal to 20% – 25% of fund returns, the dollar effect would be 2.0% – 2.5% (20% – 25% of 10%) of the dollar change in values. Generally, a 10% immediate change in earnings from equity method investees. Since we generally have a 1% – 5% investment in these funds, the dollar effect would be 0.1% – 0.5% (1% – 5% of 10%) of the dollar change in values. (D) Castles None None None

(A) For funds formed after March 2006 which are no longer in the commitment period, a 10% change in the fair value of their $700.4 million of investments held in publicly traded entities would affect management fees by 10% of the management fees based on the value of such investments on a prospective basis, subsequent to the change in value. (B) Except for one private equity fund whose incentive income is not subject to clawback, where the effect would be similar to that on a hedge fund. (C) We have 27.9%, 14.4% and 16.7% interests, respectively, in Florida Co, FRIC and Real Assets, in which we had invested $218.0 million, $52.5 million and $8.2 million, respectively, as of September 30, 2007. (D) We have a 18.3% interest in one hybrid hedge fund in which we had invested $215.5 million as of September 30, 2007.

A 10% increase or decrease in the fair value of investments held by Fortress Funds as of September 30, 2007 would have increased or decreased our results on an unconsolidated basis for the nine months ended September 30, 2007 by $217.9 million or ($97.3 million), respectively. These changes are comprised of an increase or decrease of incentive income from hedge funds of $120.6 million or ($0.0 million), respectively, and of an increase or decrease of earnings from equity method investees from private equity funds of $51.9 million, liquid hedge funds of $8.5 million, and hybrid hedge funds of $36.9 million.

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, 2007. The categories displayed below do not correspond directly with the disclosures which will be required under SFAS No. 157, described under ''— Recent Accounting Pronouncements'' below.

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Fair Value Based on	Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds	Total Investment Company Holdings
Quoted market prices	44 %	68 %	10 %	38 %
Other observable market parameters (including valuations based on reports of independent valuation agents and internal models with significant observable market parameters)	15 %	31 %	86 %	41 %
Internal models with significant unobservable market parameters	41 %	1 %	4 %	21 %
Total	100 %	100 %	100 %	100 %

As of September 30, 2007, $6,465.2 million of investments in our private equity funds, $77.4 million of investments in our liquid hedge funds and $469.3 million of investments in our hybrid hedge 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 through internal models with significant unobservable market parameters would have had the following increase or decrease on our results on an unconsolidated basis for the nine months ended September 30, 2007, consistent with the table above:

	Private Equity Funds	Liquid Hedge Funds	Hybrid Hedge Funds
Management fees, on a prospective basis	N/A (A)	$0.2 million	$0.6 million
Incentive fees	N/A (B)	$1.2 million or ($0.0 million)	N/A (C)
Earnings from equity method investees	$21.5 million	$0.1 million	$1.6 million

(A) Private equity fund management fees would be 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. (B) Private equity 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 on a valuation. (C) Hybrid hedge fund incentive income would be unchanged as it is not recognized until received and all contingencies are resolved in the fourth quarter. Incentive income is generally not charged on amounts invested by hybrid hedge funds in funds managed by external managers.

The effects on private equity fees and income assume that a decrease in value does not cause a permanent write-down of investments below their associated invested capital. Our equity, net income, and overall financial condition (as well as results of operations following the deconsolidation of the previously consolidated Fortress Funds on March 31, 2007) are only moderately sensitive to changes in these assumptions and estimates.

Income Taxes

Historically, we operated as a limited liability company which was not subject to U.S. federal and had limited state income taxes. However, certain of our consolidated subsidiaries are subject to UBT on their trade and business activities conducted in New York City. The UBT rates vary significantly between the rate applicable to income from business activities and the rate applicable to income from investment activities. Allocation of income between business activities and investing activities is subject to detailed and complex rules applied to facts and circumstances that generally are not readily determinable at the date financial statements are prepared. Accordingly, estimates are made of income allocations in computing our effective tax rate that might be different from actual allocations determined when tax returns are prepared by investee companies and subsidiaries.

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As a result of the completion of the transactions resulting from the initial public offering, and the reorganization of our businesses, FIG Corp. is subject to U.S. federal and state income tax on income allocated to it from Fortress Operating Group. FIG Corp.'s carrying value of Fortress Operating Group is higher for income tax purposes than for financial reporting purposes. The net deferred tax asset that has been recognized for this difference is limited to the tax benefit expected to be realized in the foreseeable future. This benefit was estimated based on a number of factors, with an important factor being the amount of unrealized gains in all of the net assets of Fortress Operating Group existing for tax purposes at the date of the reorganization that are expected to be realized for tax purposes in the foreseeable future. If our estimate of the unrealized gains at the date of our initial public offering that actually will be realized in the future increases or decreases, deferred income tax expense or benefit will be recognized.

For the period January 17, 2007, the reorganization date, through September 30, 2007, an estimated annual (January 17, 2007 through December 31, 2007) negative effective tax rate of (5.18%) was used to compute the tax provision on our income subject to U.S. federal, state and local income taxes. We incurred a loss before income taxes for financial reporting purposes, after deducting the compensation expense arising from the principals' forfeiture agreement (Note 7 to Part I, Item 1, ''Financial Statements — Equity-Based Compensation''). However, this compensation expense is not deductible for income tax purposes. Also, after the reorganization, a portion of our income is not subject to U.S. federal corporate income tax but is allocated directly to our shareholders.

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

As a result of the foregoing, 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, would cause us to incur a material increase in our tax liability. See ''— Factors Affecting Our Business — Income Tax Expense.''

Equity-Based Compensation

We currently have seven categories of equity-based compensation which are described in Note 7 to Part I, Item 1, ''Financial Statements — Equity-Based Compensation.'' The aggregate fair value of each of the RSU grants that are subject to service conditions is reduced by an estimated forfeiture factor (that is, the estimated amount of awards which will be forfeited prior to vesting). The estimated forfeiture factor is based upon historic turnover rates within our company adjusted for the expected effects of the grants on turnover and other factors in the best judgment of management. The estimated forfeiture factor is updated at each reporting date. Since our IPO in February 2007, neither our actual forfeiture rate nor any other factors have caused us to change our forfeiture expectations or assumptions.

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

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The following elements of the accounting for equity-based compensation are subject to significant judgment and estimation:

– the estimated forfeiture factor;

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

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

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

Each of these elements, particularly the forfeiture factor and the volatility assumptions used in valuing certain awards, are subject to significant judgment and variability and the impact of changes in such elements on equity-based compensation expense could be material. Increases in the assumed forfeiture factor would decrease compensation expense. Increases in the volatility assumption would (i) decrease compensation expense related to RSUs with no service conditions since the discount for delayed delivery would have increased, and (ii) increase compensation expense related to the LTIP since the value of the LTIP would have increased. Increases in the assumed risk-free rate would (i) decrease compensation expense related to RSUs which do not entitle recipients to dividend equivalents since the estimated value of the foregone dividends would have increased, thereby increasing the discount related to their non-receipt, (ii) decrease compensation expense related to RSUs with no service conditions since the discount for delayed delivery would have increased, and (iii) increase compensation expense related to the LTIP since the value of the LTIP would have increased. Except for the forfeiture factor, changes in these assumptions will only affect awards made in the future and awards whose accounting is impacted by changes in their fair value (generally those to non-employees, known as ‘‘liability awards’’).

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (‘‘FASB’’) issued Interpretation No. 48, ‘‘Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109’’ (‘‘FIN 48’’). FIN 48 requires companies to recognize the tax benefits of uncertain tax positions only where the position is ‘‘more likely than not’’ to be sustained assuming examination by tax authorities. The tax benefit recognized is the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 did not have a material impact on our financial condition, liquidity or results of operations.

In February 2006, the FASB issued Statement of Financial Accounting Standards (‘‘SFAS’’) No. 155, ‘‘Accounting for Certain Hybrid Financial Instruments,’’ which amends SFAS 133, ‘‘Accounting for Derivative Instruments and Hedging Activities,’’ and SFAS 140, ‘‘Accounting for Transfers and Servicing of Financial Assets and Extinguishments of

Liabilities.'' SFAS 155 provides, among other things, that (i) for embedded derivatives which would otherwise be required to be bifurcated from their host contracts and accounted for at fair value in accordance with SFAS 133 an entity may make an irrevocable election, on an instrument-by-instrument basis, to measure the hybrid financial instrument at fair value in its entirety, with changes in fair value recognized in earnings and

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(ii) concentrations of credit risk in the form of subordination are not considered embedded derivatives. SFAS 155 is effective for all financial instruments acquired, issued or subject to remeasurement after the beginning of an entity's first fiscal year that begins after September 15, 2006. Upon adoption, differences between the total carrying amount of the individual components of an existing bifurcated hybrid financial instrument and the fair value of the combined hybrid financial instrument should be recognized as a cumulative effect adjustment to beginning retained earnings. Prior periods are not restated. The adoption of SFAS 155 did not have a material impact on our financial statements.

In June 2007 Statement of Position No. 07-1, ''Clarification of the Scope of the Audit and Accounting Guide — Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies'' (''SOP 07-1'') was issued. SOP 07-1 addresses whether the accounting principles of the Audit and Accounting Guide for Investment Companies may be applied to an entity by clarifying the definition of an investment company and whether those accounting principles may be retained by a parent company in consolidation or by an investor in the application of the equity method of accounting. SOP 07-1 applies to reporting periods beginning on or after December 15, 2007. We are currently evaluating the potential effect on our financial condition, liquidity and results of operations upon adoption of SOP 07-1. If the status of any of our investees as investment companies (or not) were to change as a result of the adoption of SOP 07-1, this could have a material impact on our financial statements and our ability to report the activities of such investee(s) on a timely basis. In October 2007, the FASB voted to indefinitely postpone the adoption of SOP 07-1.

In September 2006, the FASB issued SFAS No. 157, ''Fair Value Measurements.'' SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies to reporting periods beginning after November 15, 2007. The adoption of SFAS 157 is not expected to have a material impact on our financial condition, liquidity or results of operations.

In February 2007, the FASB issued SFAS No. 159, ''The Fair Value Option for Financial Assets and Financial Liabilities.'' SFAS 159 permits entities to choose to measure many financial instruments, and certain other items, at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 applies to reporting periods beginning after November 15, 2007. We are currently evaluating the potential effect on our financial condition, liquidity and results of operations upon adoption of SFAS 159. This impact could be material if we elected to measure material investments, such as non-investment company equity method investees, or debt, at fair value.

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. Our investment in the funds continues to impact our net income in a similar way after the deconsolidation of the Fortress 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.''

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Contractual Obligations

Our future contractual obligations increased from $1.1 billion on a pro forma deconsolidated basis as of December 31, 2006 to $1.23 billion as of September 30, 2007.

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As a result of deconsolidation, the contractual obligations of the Fortress Funds were no longer considered obligations of Fortress as of March 31, 2007. These contracts include investment company debt obligations that had a total payable balance of $3.9 billion at December 31, 2006.

Our debt obligations payable decreased from $836.1 million as of December 31, 2006 (on a pro forma deconsolidated basis) to $552.1 million as of September 30, 2007, including estimates for interest payments. This decrease was attributable to our completion of an initial public offering on February 8, 2007, of 39,428,900 of our Class A shares, including the underwriters' over allotment option, for net proceeds of $652.7 million of which $250.0 million and $85.0 million were paid on our outstanding term loan facility and revolving credit facility, respectively. In addition to the pay-down of the debt obligations payable, future interest payable on that obligation payable was reduced.

Our capital commitments, including our commitments to our funds, have increased by $43.7 million from $137.4 million as of December 31, 2006 (on a pro forma deconsolidated basis) to $181.1 million as of September 30, 2007. The increase is primarily attributable to our capital commitments to our newly formed funds, Fortress Florida Coinvestment Fund, Fortress Investment Fund V and the Real Assets Fund, in which we have outstanding capital commitments of $48.7 million, $50.9 million and $41.8 million, respectively, as of September 30, 2007. The increased commitments to these funds were partially offset by the draw down of $66.8 million, $10.5 million and $16.6 million of the capital commitment to FHIF, Fortress Investment Fund IV and FRID, respectively.

In February 2007, the corporate taxpayers (i.e., FIG Corp.) entered into a tax receivable agreement with each of the principals that provides for the payment to an exchanging or selling principal of 85% of the amount of cash savings, if any, in U.S. federal, state, local and foreign income tax that the corporate taxpayers actually realize (or are deemed to realize in the case of an early termination payment by the corporate taxpayers or a change of control, as defined) as a result of an increase in the tax basis of the assets owned by Fortress Operating Group at the time of an exchange of a Fortress Operation Group limited partnership unit for one of the Class A shares. Such payments are expected to occur over approximately the next 15 years. In connection with the Nomura transaction and related tax effects, a $390 million capital decrease and offsetting liability to the principals was recorded with respect to the tax receivable agreement. It is currently anticipated that no payments will be made with respect to the tax receivable agreement in 2007. Starting in 2008 and continuing several years thereafter, it is expected that payments of $20 to $25 million per annum will be made pursuant to the tax receivable agreement. This projection is based on several assumptions, including management's expectation that benefits associated with the increase in the tax basis of assets will be realized over the next four years.

The adoption of FIN 48 did not have a material impact on our financial condition, liquidity or results of operations and therefore did not cause us to incur any material contractual obligations.

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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.

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. Prior to the deconsolidation of the consolidated Fortress Funds, the net effect of these fair value changes impacted the gains (losses) from investments in our consolidated statements of operations while the majority of these fair value changes were absorbed by the other interest holders in consolidated subsidiaries. As of September 30, 2007 and on a prospective basis, fluctuations in the fair value of the Fortress Funds will continue to directly affect the value of our investments in the Fortress Funds and thereby our earnings 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.

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

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

- the investment process of our private equity funds involves a detailed analysis of potential acquisitions, and asset management teams assigned to oversee the strategic development, financing and capital deployment decisions of each portfolio investment;
- our hybrid hedge funds and Castles perform extensive credit and cash-flow analysis of borrowers, tenants and credit-based assets, and have extensive asset management teams that monitor covenant compliance by, and relevant financial data of, borrowers, tenants and other obligors, asset pool performance statistics, tracking of cash payments relating to investments, and ongoing analysis of the credit status of investments; and
- our liquid hedge funds continuously monitor a variety of markets for attractive trading opportunities, applying a number of traditional and customized risk management metrics to analyze risk related to specific assets or portfolios, as well as fund-wide risks.

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, 2007:

Assets	
Equity method investees	$ 990,441
Options in affiliates	48,351
	$ 1,038,792
Liabilities	
Derivative liabilities, at fair value	$ 5,132
Other debt obligations payable	425,000
	$ 430,132

The Fortress Funds are sensitive to changes in market and exchange rate risk factors that impact management fees and incentive income earned by Fortress Operating Group, which are reflected in our historical consolidated financial statements as an allocation of income from consolidated Fortress Funds. Financial assets and liabilities of Fortress

Operating Group that are impacted by changes in the value of securities, foreign exchange, and interest rates are debt obligations payable, options in affiliates and foreign currency forward contracts entered into to economically hedge the risk of fluctuations in foreign currency exchange rates with respect to its foreign investments.

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Fortress Funds’ Market Risk Impact on Management Fees

Our management fees are 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 our 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, 2007, approximately 61.9% of our management fees earned were based on the NAV of the applicable funds.

- Management fees from our hedge funds are based on their NAV, which in turn is dependent on the estimated fair values of their investments. Assuming that there is no change to the investments held by the hedge funds in the next four quarters after September 30, 2007, a 10% change in the fair values of all of the investments held by our hedge funds as of September 30, 2007 would impact future management fees in the next year from our hedge funds by $31.2 million.
- For private equity funds, management fees of 1% to 1.5% 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 funds formed after March 2006. For funds formed after March 2006 that are no longer in the investment period, management fees are earned on the NAV of investments in publicly traded entities (to the extent they exceed invested capital), and a 10% change in these fair values would impact management fees in the next year by $0.6 million.
- For Castles, management fees are not calculated based on NAV but instead a 1.5% fee is charged based on the funds’ paid-in equity.

Changes in values of investments could indirectly affect future management fees from private equity funds and Castles by, among other things, reducing the funds’ access to capital or liquidity and their ability to currently pay the management fees or for private equity funds if such change resulted in a write-down of investments below their associated invested capital.

Fortress Funds’ Market Risk Impact on Incentive Income

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

- Incentive income from our hedge funds, which is quantified in Part I, Item 2, ‘‘Management’s Discussion and Analysis of Financial Condition and Results of Operations — Segment Analysis’’ section, 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 quarterly or annual performance criteria. For the hedge funds with quarterly performance criteria, a 10% decrease to the NAV of the fund on September 30, 2007 would have resulted in a loss to investors for the quarter. In future quarters, this loss would be a ‘‘high water mark’’ (minimum future return to recover the loss to the investors) for our funds’ performance prior

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to any incentive income being earned by us. This ‘‘high water mark’’ is reset on an annual basis. For the hedge funds with annual performance criteria, a 10% decrease to the NAV of the fund on September 30, 2007, assuming that NAV is constant for the rest of the current year, would result in no incentive income recorded as revenue at year end (in the fourth quarter of the year).

- Incentive income from our private equity 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 at September 30, 2007 would increase or decrease future incentive income by $245.2 million or ($105.6 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 do not impact the measure of current operating results (i.e. FFO in excess of specified returns to the company’s shareholders) upon which the incentive income is calculated. The definition of FFO excludes unrealized changes in the values of the Castles’ investments (primarily real estate, loans and securities), except for minor items (for example, the unrealized gain or loss on non-hedge derivatives which make up only an immaterial portion of their assets).

Market Risk

Our investments in the Fortress Funds accounted for under the equity method, to the extent they are investment companies, are directly affected by the impact of changes in market risk factors on the investments held by our Fortress Funds, which could vary significantly from fund to fund. We estimate that a 10% change in the value of our equity method investments in these Fortress Funds as of September 30, 2007 would increase or decrease earnings from equity method investees by $97.5 million.

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, 2007, we estimate that interest expense relating to variable rate debt obligations payable would increase $4.3 million on an annual basis in the event interest rates were to increase by one percentage point.

Equity Prices and Exchange Rate Risk

We are not materially exposed to foreign exchange risk since foreign investments are economically hedged by foreign currency forward contracts.

Gains (losses) on options granted to us by one of the Castles are affected by movements in (i) the equity price of the underlying shares and (ii) the rate of exchange between the U.S. dollar and the Euro. Analyzed separately, we estimate that a 10% increase (decrease) in the equity price of the underlying shares of the options on September 30, 2007 would affect gains and losses for the nine months ended September 30, 2007 by $13.5 million and ($12.4 million), respectively. In the event of a 10% change in the applicable foreign exchange rate against the U.S. dollar on September 30, 2007, we estimate the gains and losses for the nine months ended September 30, 2007 in relation to the value of the options would increase or decrease by $4.8 million.

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ITEM 4. CONTROLS AND PROCEDURES

(a)

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 are effective.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On September 15, 2005, a lawsuit captioned David T. Atkins et al. v. Apollo Real Estate Advisors, L.P. et al., which we refer to as the Brookdale Action, was brought in the United States District Court for the Eastern District of New York on behalf of current and former limited partners in certain investing partnerships related to the sale of certain facilities to Ventas Realty Limited Partnership, or Ventas, an unaffiliated real estate investment trust. It names as defendants, among others, Brookdale Senior Living, Inc. (one of our portfolio companies, which we refer to as Brookdale), Brookdale Living Communities, Inc. (a subsidiary of Brookdale, which we refer to as BLC), GFB-AS Investors, LLC (which we refer to as GFB-AS), a subsidiary of BLC, the general partners of 14 investing partnerships which are alleged to be subsidiaries of GFB-AS, Fortress, and the Chief Financial Officer of Brookdale. Fortress was the investment manager of consolidated Fortress Funds which were controlling shareholders of the private equity portfolio company during the relevant time periods. The suit alleges that the defendants improperly obtained certain rights with respect to such facilities from the investing partnerships. The plaintiffs' nine count third amended complaint alleges, among other things, (i) that the defendants converted for their own use the property of the limited partners of 11 partnerships, including through the failure to obtain consents the plaintiffs contend were required for the sale of facilities indirectly owned by those partnerships to Ventas; (ii) that the defendants fraudulently persuaded the limited partners of three partnerships to give up a valuable property right based upon incomplete, false and misleading statements in connection with certain consent solicitations; (iii) that certain defendants, not including the company, committed mail fraud in connection with the sale of facilities indirectly owned by the 14 partnerships at issue in the Brookdale Action to Ventas; (iv) that certain defendants committed wire fraud in connection with certain communications with plaintiffs in the Brookdale Action and another investor in a limited partnership; (v) that the defendants committed substantive violations of the Racketeer Influenced and Corrupt Organizations Act, or RICO; (vi) that the defendants conspired to violate RICO; (vii) that GFB-AS and the general partners violated the partnership agreements of the 14 investing partnerships; (viii) that GFB-AS, the general partners, and Brookdale's Chief Financial Officer breached fiduciary duties to the plaintiffs; and (ix) that the defendants were unjustly enriched. The plaintiffs have asked for damages in excess of $100 million on each of nine counts, as to which Fortress is a defendant on seven counts, including treble damages with respect to certain counts. Fortress has filed a motion to have itself removed as a named defendant in this case. Brookdale has filed a motion to dismiss the claims and continues to vigorously defend this action. We believe that the resolution of this action will not have a material adverse effect on our financial condition or results of operations.

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

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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

We depend on Messrs. Briger, Edens, Kauffman, Nardone and Novogratz, and the loss of any of their services would 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 would 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. We do not carry any ‘‘key man’’ insurance that would provide us with proceeds in the event of the death or disability of any of our principals.

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

The principals have also entered into an agreement among themselves, which provides that, in the event a principal voluntarily terminates his employment with us for any reason prior to the fifth anniversary of the consummation of our initial public offering, the principal may be required to forfeit a portion of his Fortress Operating Group units (and the corresponding Class B shares) to the other principals who continue to be employed by the Fortress Operating Group. However, this agreement may be amended by the principals who are then employed by the Fortress Operating Group. We, our shareholders and the Fortress Operating Group 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 would be materially adversely affected.

Several of our funds have ‘‘key man’’ provisions pursuant to which the failure of one or more of our principals to be actively involved in the business provides investors with the right to redeem from the funds or otherwise limits our rights to manage the funds. The loss of the services of any one of Messrs. Briger, Edens or Novogratz, or both of Mr. Kauffman and Mr. Nardone, would have a material adverse effect on certain of our funds and on us.

Investors in most of our hedge funds may generally redeem their investment without paying redemption fees if the relevant principal 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 man’’ 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 principal ceases to perform his functions with respect to the fund and a replacement has not been approved.

The loss or inability of Mr. Novogratz to perform his services for 90 days could result in substantial withdrawal requests from investors in our Drawbridge Global Macro funds (which as of September 30, 2007, had AUM of approximately $7.5 billion) and, in the event that a replacement is not approved, the termination of a substantial portion of the funds’ financing arrangements. Such withdrawals and terminations would have a material adverse effect on the Drawbridge Global Macro funds by reducing our management fees from those funds and, since the funds would have fewer assets, such withdrawals would reduce the amount of incentive income potential of those funds. Further, such withdrawals and terminations could lead possibly to the liquidation of the funds and a corresponding elimination of our management fees and potential to earn incentive income from those funds. The loss of Mr. Novogratz could, therefore, ultimately result in a loss of substantially all of our earnings attributable to our liquid hedge fund business segment.

The loss or inability of Mr. Briger to perform his services for 90 days could result in substantial withdrawal requests from investors in our Drawbridge Special Opportunities funds (which as of September 30, 2007, had AUM of approximately $7.3 billion) and, in the event that a replacement for him is not approved, the termination of a substantial portion of the funds’ financing arrangements. Such withdrawals and terminations would have a material adverse effect on the Drawbridge Special Opportunities funds by reducing our management fees from those funds and, since the funds would have fewer assets, such withdrawals would reduce the amount of incentive income potential of 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. The loss or inability of Mr. Briger to perform his services or devote an appropriate portion of his business time to the long dated value funds for 90 days would (unless approved by a majority of fund investors) prevent the Drawbridge long dated value funds from making additional investments. This could have a material adverse effect on the long dated value funds, resulting in us receiving reduced management fees and incentive income. The loss of Mr. Briger could, therefore, ultimately result in a loss of substantially all of our earnings attributable to our hybrid hedge fund business segment with respect to the Drawbridge Special Opportunities funds, and a relatively small loss of earnings attributable to our private equity fund business segment with respect to the long dated value funds.

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 fund business segment, which as of September 30, 2007, had AUM of approximately $20.9 billion.

Any such events would have a direct material adverse effect on our revenues and earnings, and would likely harm our ability to maintain or grow 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 recruit additional qualified personnel. We collectively refer to these key employees (other than our principals) as our investment professionals. We anticipate that it

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will be necessary for us to add investment professionals as we pursue our growth strategy. However, we may not succeed in recruiting additional personnel or retaining current personnel, as the market for qualified investment professionals is extremely competitive. Our investment professionals possess substantial experience and expertise in investing, are responsible for locating and executing our funds' investments, have significant relationships with the institutions which are the source of many of our funds' investment opportunities, and in certain cases have strong relationships with our investors. Therefore, if our investment professionals join competitors or form competing companies it could result in the loss of significant investment opportunities and certain existing investors. As a result, the loss of even a small number of our investment professionals could jeopardize the performance of our funds, which could have a material adverse effect on our results of operations as well as our ability to retain and attract investors and raise new funds. Efforts to retain or attract investment professionals may result in significant additional expenses, which could adversely affect our profitability.

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

Our assets under management have grown from approximately $1.2 billion as of December 31, 2001 to $39.9 billion as of September 30, 2007. Our rapid growth has caused, and if it continues will continue to cause, significant demands on our legal, accounting and operational infrastructure, and increased expenses. The complexity of these demands, and the expense required to address them, is a function not simply of the amount by which our assets under management have grown, but of significant differences in the investing strategies of our different funds. In addition, we are required to continuously develop our systems and infrastructure in response to the increasing sophistication of the investment management market and legal, accounting and regulatory developments. Moreover, the strains upon our resources caused by our growth are compounded by the additional demands imposed upon us now that we are a public company with shares listed on the New York Stock Exchange and, thus, subject to an extensive body of regulations that did not apply to us prior to our initial public offering.

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

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

There can be no assurance that we will be able to manage our expanding operations effectively or that we will be able to continue to grow, and any failure to do so could adversely affect our ability to generate revenue and control our expenses.

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

We face operational risk from errors made in the 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 and hybrid hedge 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 or are disabled, we could suffer financial loss, a disruption of our businesses, liability to our funds, regulatory intervention and reputational damage.

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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 growth, or that the cost of maintaining such systems will not increase from its current level. Such a failure to accommodate growth, or an increase in costs related to such information systems, could have a material adverse effect on us.

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

Finally, we rely on third party service providers for certain aspects of our business, including certain financial operations of our hedge funds. Any interruption or deterioration in the performance of these third parties could impair the quality of the funds' operations and could impact our reputation and adversely affect our business and limit our ability to grow.

The historical and unaudited pro forma financial information included in this report is not necessarily indicative of our future performance.

The historical combined financial information included in this report is not necessarily indicative of our future financial results. Our historical combined financial information consolidates a large number of our significant funds, which will not be consolidated in future periods as a result of the consummation of the deconsolidation of such funds on March 31, 2007. In addition, the historical combined financial information included in this report does not reflect the added costs that we will incur as a public company or the impact of changes in our structure that we implemented immediately after the consummation of our initial public offering in February 2007, for periods prior to that date. Moreover, because we operated through limited liability companies prior to our initial public offering, we paid little or no taxes on profits. However, we are now subject to certain taxation on our profits as a result of the changes we made to our structure in connection with our initial public offering.

The results of future periods are likely to be materially different as a result of:

- the impact of transactions occurring in connection with our initial public offering in relation to the size of the company during earlier periods;
- fund performance in the future which differs from the historical performance reflected in our financial information for earlier periods; and
- the pace of growth of our business in the future, including the formation of new funds, which differs from the historical growth reflected in our financial information for earlier periods.

Accordingly, our historical combined financial information is not intended to be, and should not be regarded as, indicative of our future performance.

In addition, we have provided in this report pro forma financial information regarding the impact of the deconsolidation of a number of Fortress Funds, which took place on March 31, 2007, on our historical combined financial information as of December 31, 2006 and for the nine months ended September 30, 2007. The pro forma adjustments, which are based on available information and certain assumptions that we believe are reasonable, have been applied to this historical combined financial information. The pro forma financial information is provided for informational purposes only and does not purport to represent or be indicative of the results that actually would have been obtained had the deconsolidation occurred on December 31, 2006 or January 1, 2007, or that may be obtained for any future period. See Note 12 to Part I, Item 1, ''Financial Statements — Pro Forma Financial Information (Unaudited).''

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 terms of our funds generally give either the general partner of the fund or the fund's board of directors the right to terminate our investment management agreement with the fund. However, insofar as we control the general partner of our funds which are limited partnerships, the risk of termination of investment management agreement for such funds is 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. As of September 30, 2007, we had $7.6 billion of assets under management in our offshore hedge funds.

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

In addition, following the deconsolidation, investors in any private equity fund and certain hedge funds have the ability to act, without cause, to accelerate the date on which the fund must be wound down. 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 which 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 board of directors of certain hedge funds have the right under certain circumstances to terminate the investment management agreements with the applicable fund. Termination of these agreements would affect the fees we earn from the relevant funds, which could have a material adverse effect on our results of operations.

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

In general, we will be exposed to risk of litigation by our investors if our management of any fund is alleged to constitute gross negligence or willful misconduct. Investors could sue us to recover amounts lost by our funds due to our alleged misconduct, up to the entire amount of loss. Further, we may be subject to litigation arising from investor dissatisfaction with the performance of our funds or from allegations that we improperly exercised control or influence over companies in which our funds have large investments. By way of example, we, our funds and certain of our employees, are each exposed to the risks of litigation relating to investment activities in our funds and actions taken by the officers and directors (some of whom may be Fortress employees) of portfolio companies, such as risks relating to a funds' high-yield lending activities and the risk of shareholder litigation by other shareholders of public companies in which our funds have large investments. In addition, we are exposed to risks of litigation or investigation relating to transactions which presented conflicts of interest that were not properly addressed. In such actions we would be obligated to bear legal, settlement and other costs (which may be in excess of available insurance coverage). In addition, although we are indemnified by the funds we manage, our rights to indemnification may be challenged. If we are required to incur all or a portion of the costs arising out of litigation or investigations as a result of inadequate insurance proceeds or failure to obtain indemnification from our funds, our results of operations, financial condition and liquidity could be materially adversely affected.

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In our liquid hedge funds, we are exposed to the risk of litigation if the funds suffer catastrophic losses due to the failure of a particular investment strategy or due to the trading activity of an employee who has violated market rules and regulations. Any litigation arising in such circumstances is likely to be protracted, expensive and surrounded by circumstances which are materially damaging to our reputation and our business. In addition, we face the risk of litigation from investors in our private equity funds and hybrid hedge funds if we violate restrictions in such funds' organizational documents (for example, by failing to seek approval for related party transactions requiring approval or by exceeding the mandate of such funds).

Our liquid hedge funds, our offshore hybrid hedge fund and many of our private equity funds are incorporated or formed under the laws of the Cayman Islands. Cayman Islands laws, particularly with respect to shareholders rights, partner rights and bankruptcy, may differ from the laws of the United States. Cayman Islands laws could change, possibly to the detriment of our funds and investment management subsidiaries.

In addition, with a workforce consisting of many very highly paid investment professionals, we face the risk of lawsuits relating to claims for compensation, which may individually or in the aggregate be significant in amount. The cost of settling such claims could adversely affect our results of operations.

Our reputation, business and operations could be adversely affected by regulatory compliance failures, the potential adverse effect of changes in laws and regulations applicable to our business and effects of negative publicity surrounding the hedge fund 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 our investing activities, such as our lending business, are subject to regulation by various U.S. state regulators. In the United Kingdom, we are subject to regulation by the U.K. Financial Services Authority. Our other European operations, and our investment activities around the globe, are subject to a variety of regulatory regimes that vary country by country.

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

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

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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 that our businesses are subject to are designed primarily to protect investors in our funds and to ensure the integrity of the financial markets. They are not designed to protect our Class A shareholders. Even if a sanction imposed against us or our personnel by a regulator is for a small monetary amount, the adverse publicity related to such sanction against us by regulators could harm our reputation, result in redemptions by investors from our hedge funds and impede our ability to raise additional capital or new funds.

As a result of recent highly-publicized financial scandals, investors have exhibited concerns over the integrity of the U.S. financial markets, and the regulatory environment in which we operate is subject to heightened regulation. In recent years, there has been debate in both the U.S. and foreign governments about new rules or regulations to be applicable to hedge funds or other alternative investment products. For example, certain officials in Germany have called for implementing these types of additional regulations, which, if enacted, could potentially apply to our business activities throughout the European Union. We may be adversely affected if new or revised legislation or regulations are enacted, or by changes in the interpretation or enforcement of existing rules and regulations imposed by the SEC, other U.S. or foreign governmental regulatory authorities or self-regulatory organizations that supervise the financial markets. Such changes could place limitations on the type of investor that can invest in alternative asset funds or on the conditions under which such investors may invest. Further, such changes may limit the scope of investing activities that may be undertaken by alternative asset managers. Any such changes could increase our costs of doing business or materially adversely affect our profitability.

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 which have different fee structures, and potential conflicts may arise with respect to our decisions regarding how to allocate investment opportunities among those funds. For example, a decision to acquire material non-public information about a company while pursuing an investment opportunity for a particular fund gives rise to a potential conflict of interest when it results in our having to restrict the ability of other funds to take any action. In addition, holders of Class A shares may perceive conflicts of interest regarding investment decisions for funds in which our principals, who have and may continue to make significant personal investments in a variety of Fortress Funds, are personally invested. Similarly, conflicts of interest may exist or develop regarding decisions about the allocation of specific investment opportunities between Fortress and the Fortress Funds. In addition, because the Operating Entities are held, in part, by FIG Corp., which is subject to tax, conflicts of interest may exist regarding decisions about which of Fortress’s holdings should be held by Operating Entities and which by Principal Holdings.

Pursuant to the terms of our operating agreement, whenever a potential conflict of interest exists or arises between any of the principals, one or more directors or their respective affiliates, on the one hand, and the company, any subsidiary of the company or any member other than a principal, on the other, any resolution or course of action by our board of directors shall be permitted and deemed approved by all shareholders if the resolution or course of action (i) has been specifically approved by a majority of the members of a committee composed entirely of two or more independent directors, or it is deemed approved because it complies with rules or guidelines established by such committee, (ii) has been approved by a majority of the total votes that may be cast in the election of directors that are held by disinterested parties, (iii) is on terms no less favorable to the company or shareholders (other than a principal) than those generally being provided to or available from unrelated third parties or (iv) is fair and reasonable to the company taking into account the totality of the relationships between the parties involved. Notwithstanding the foregoing, it is possible that potential or perceived conflicts could give rise to investor dissatisfaction or litigation or regulatory enforcement actions. Appropriately dealing with conflicts of interest is complex and difficult and our

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reputation could be damaged if we fail, or appear to fail, to deal appropriately with one or more potential or actual conflicts of interest. Regulatory scrutiny of, or litigation in connection with, conflicts of interest would have a material adverse effect on our reputation, which would materially adversely affect our business in a number of ways, including as a result of redemptions by our investors from our hedge funds, an inability to raise additional funds and a reluctance of counterparties to do business with us.

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

Our reputation is critical to maintaining and developing relationships with the investors in our funds, potential investors and third-parties with whom we do business. In recent years, there have been a number of highly-publicized cases involving fraud, conflicts of interest or other misconduct by individuals in the financial services industry in general and the hedge fund industry in particular. There is a risk that our employees could engage in misconduct that adversely affects our business. For example, if an employee were to engage in illegal or suspicious activities, we could be subject to regulatory sanctions and suffer serious harm to our reputation, financial position, investor relationships and ability to attract future investors. It is not always possible to deter employee misconduct, and the precautions we take to detect and prevent this activity may not be effective in all cases. Misconduct by our employees, or even unsubstantiated allegations, could result in a material adverse effect on our reputation and our business.

The investment management business is intensely competitive.

Over the past several years, the size and number of hedge funds and private equity funds has continued to increase. If this trend continues, it is possible that it will become increasingly difficult for our funds to raise capital. More significantly, the allocation of increasing amounts of capital to alternative investment strategies by institutional and individual investors may lead to a reduction in profitable investment opportunities, including by driving prices for investments higher and increasing the difficulty of achieving targeted returns. In addition, if interest rates were to rise or there were to be a prolonged bull market in equities, the attractiveness of our funds relative to investments in other investment products could decrease. Competition is based on a variety of factors, including:

- investment performance;
- investor perception of investment managers' drive, focus and alignment of interest;
- quality of service provided to and duration of relationship with investors;
- business reputation; and
- level of fees and expenses charged for services.

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

- investors may develop concerns that we will allow a business to grow to the detriment of its performance;
- some of our competitors have greater capital, 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 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;
- there are relatively few barriers to entry impeding new private equity and hedge fund management firms, and the successful efforts of new entrants into our various lines of business, including former ‘‘star’’ portfolio managers at large diversified financial institutions as well as such institutions themselves, will continue to result in increased competition; and
- other industry participants continuously seek to recruit our best and brightest investment professionals away from us.

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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. However, there is a risk that fees in the alternative investment management industry will decline, without regard to the historical performance of a manager. Fee reductions on existing or future funds, without corresponding decreases in our cost structure, would adversely affect our revenues and profitability.

Our internal control over financial reporting does not currently meet all of the standards contemplated by Section 404 of the Sarbanes-Oxley Act of 2002, and failure to achieve and 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.

Our internal control over financial reporting may not currently meet all of the standards contemplated by Section 404 of the Sarbanes-Oxley Act that we will be required to meet as of December 31, 2007. We are in the process of addressing our internal controls over financial reporting and have established formal committees to oversee our policies and processes related to financial reporting and to the identification of key financial reporting risks, assessment of their potential impact and linkage of those risks to specific areas and activities within our organization.

While we do not believe we have any material weaknesses in our internal controls, we have not yet fully tested our internal controls in accordance with Section 404. As a result, we cannot conclude in accordance with Section 404 that we do not have a material weakness, or possibly a combination of significant deficiencies which could result in the conclusion that we have a material weakness in our internal controls in accordance with such rules.

We are in the process of documenting and testing our internal control procedures to satisfy the requirements of Section 404, which requires annual management assessments of the effectiveness of our internal control over financial reporting and, beginning with our fiscal 2008 annual report, a report by our independent registered public accounting firm assessing the effectiveness of our internal controls. As a public company, we will be required to complete our initial assessment in a timely manner. If we are not able to fully implement the requirements of Section 404 in a timely manner or with adequate compliance, our independent registered public accounting firm may not be able to certify as to the adequacy of our internal control over financial reporting. Matters impacting our internal controls may cause us to be unable to report our financial information on a timely basis and thereby subject us to adverse regulatory consequences, including sanctions or investigations by the SEC, or violations of applicable stock exchange listing rules, and result in a breach of the covenants under our credit agreement. There could also be a negative reaction in the financial markets due to a loss of investor confidence in us and the reliability of our financial statements. Confidence in the reliability of our financial statements is also likely to suffer if we or our independent registered public accounting firm reports a material weakness in our internal control over financial reporting. This could materially adversely affect us and lead to a decline in our share price and impair our ability to raise capital. In addition, we will incur incremental costs in order to improve our internal control over financial reporting and comply with Section 404, including increased accounting, auditing and legal fees and costs associated with hiring additional accounting and administrative staff.

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 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 insurance, broker-dealer or financial advisory

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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. 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 business, 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 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 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 may be limited. We cannot predict when, or 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 which may not be replicated in subsequent quarters. In addition, our private equity investments are adjusted for accounting purposes to fair value at the end of each quarter, resulting in revenue (or loss) attributable to our principal investments, even though we receive no cash distributions from our private equity funds, which could increase the volatility of our quarterly earnings. To the extent that our principal investments in our private equity funds (or direct investments in private equity transactions) are marked down, such mark downs will flow through our income statement as a GAAP loss, even in circumstances where we have a long investment horizon and have no present intention of selling the investment.

With respect to our hedge funds, our incentive income is paid annually or quarterly 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 not be able to earn incentive income from that fund until it surpasses the previous high water mark. 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.

On May 10, 2007, we refinanced our existing credit agreement with a new $1 billion credit agreement. Under the new credit agreement, we have a $200 million revolving credit facility, a $350 million term loan facility and a $450 million delayed term loan facility. As of September 30, 2007, we had a $350 million term loan outstanding, a $75 million revolver loan outstanding, no amounts outstanding under our delayed term loan facility and $10.5 million of letters of credit outstanding under the letter of credit subfacility of our revolving credit facility. Borrowings under the credit agreement mature on May 10, 2012. As our facilities mature, we will be required to either refinance them by entering into new facilities, which could result in higher borrowing costs, or issuing equity,

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which would dilute existing shareholders. We could also repay them by using cash on hand or cash from the sale of our assets. No assurance can be given that we will be able to enter into new facilities or issue equity in the future on attractive terms, or at all.

Our credit facilities are 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.

There can be no assurance that we will be successful in developing a market for our investment products in Asia or that our relationship with Nomura will yield profitable investment opportunities for the funds we manage.

On December 18, 2006, our principals entered into an agreement with Nomura pursuant to which Nomura acquired a 15% stake in Fortress for $888.0 million on January 17, 2007. Pursuant to the terms of the agreement, the parties agreed that Nomura will work with us to develop a strategy to market and sell our investment products. We believe that a strategic relationship with Nomura, the largest leading Japanese financial institution, could provide us with access to Nomura's distribution capabilities in Asia. In addition, we believe that our relationship will provide us with potential investment opportunities for the funds we manage. However, there can be no assurance that we will be able to develop a strategy and enter into a mutually satisfactory distribution agreement with Nomura, or that if reached, a market for our investment products will ever develop in Asia.

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 continued 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 would 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;
- our private equity funds' performance, which is calculated on the basis of net asset value of the funds' investments, reflect unrealized gains that may never be realized;
- our private equity

funds' performance has been positively influenced by a select number of investments that experienced rapid and substantial increases in value following the initial public offerings of the private equity portfolio companies in which those investments were made;

• our funds' returns have benefited from investment opportunities and general market conditions that 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

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

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

Our revenue from the Fortress Funds is derived principally from three sources: (1) management fees, based on the size of our funds; (2) incentive income, based on the performance of our funds; and (3) investment income from our investments in the funds, which we refer to as our ‘‘principal investments.’’ In the event that any of our funds perform poorly, our revenue and results of operations will decline, and it will likely be more difficult for us to raise new capital. In addition, hedge fund investors may withdraw their investments in our funds, while investors in private equity funds may decline to invest in future funds we raise, as a result of poor performance of our funds or otherwise. Furthermore, if, as a result of poor performance of later investments in a private equity fund’s life, 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. Our investors and potential investors continually assess our funds’ performance and our ability to raise capital.

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

If economic conditions are unfavorable, our funds may not perform well and we may not be able to raise money in existing or new funds. Our funds are materially affected by conditions in the global financial markets and economic conditions throughout the world. The global market and economic climate may deteriorate because of many factors beyond our control, including rising interest rates or inflation, terrorism or political uncertainty. In the event of a market downturn, each of our businesses could be affected in different ways. Our private equity funds may face reduced opportunities to sell and realize value from their existing investments, and a lack of suitable investments for the funds to make. In addition, adverse market or economic conditions as well as a slowdown of activities in a particular sector in which portfolio companies of these funds operate could have an adverse effect on the earnings of those portfolio companies, and therefore, our earnings.

A general market downturn, or a specific market dislocation, may cause our revenue and results of operations to decline by causing:

- the NAV of the AUM to decrease, lowering management fees;
- lower investment returns, reducing incentive income;
- material reductions in the value of our private equity fund investments in portfolio companies which reduce our ‘‘surplus’’ and, therefore, our ability to realize incentive income from these investments;
- investor redemptions, resulting in lower fees; and
- decreases in the

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, such as the hybrid hedge 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

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reduction in the value of those investments. In addition, the Castles, as well as the publicly traded portfolio companies owned by our private equity funds, currently pay a material amount of dividends. This makes their share prices vulnerable to increases in interest rates, which would, by causing declines in the value of the share prices, in turn result in lower management fees and incentive income for us, as well as potential decreases in the value of Castle shares and options held as principal investments on our balance sheet.

Changes in the debt financing markets may negatively impact the ability of our investment funds and their portfolio companies to obtain attractive financing for their investments, and may increase the cost of such financing if it is obtained, leading to lower-yielding investments and potentially decreasing our incentive income.

Over the past few months, the markets for debt financing have contracted significantly, particularly in the area of acquisition financings for private equity and leveraged buyout transactions. Large commercial banks, which have traditionally provided such financing, have demanded higher rates, more restrictive covenants and generally more onerous terms in order to provide such financing, and in some cases are not providing financing at all for acquisitions which would have been readily financed under credit conditions present for the past several years.

In the event that Fortress private equity funds are unable to obtain committed debt financing for potential acquisitions or can only obtain debt at an increased rate, this may prevent those funds from completing otherwise profitable acquisitions or may lower the profit that the funds would otherwise have achieved from such transactions, either of which could lead to a decrease in the incentive income earned by us. Similarly, the portfolio companies owned by the Fortress private equity funds regularly utilize the corporate debt markets, particularly the structured finance market, in order to obtain efficient financing for their operations. To the extent that the current credit markets have rendered such financing difficult to obtain or more expensive, this may negatively impact the operating performance of those portfolio companies and therefore the investment returns on our funds.

Our hedge funds often utilize the structured finance markets in order to obtain leverage and therefore increase the yield on certain 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, our hedge funds may be unable to make certain types of investments as the yield on those investments will be outside of the funds' target range without leverage. This could lead to those hedge funds making fewer overall investments and slowing the rate of growth of the assets under management in those funds, and a commensurate decrease in the rate of growth of our management fees.

Our Castles rely on the structured finance and mortgage markets in order to obtain leverage and therefore 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, our Castles may be unable to make investments on an accretive basis. This could slow the rate of growth of the assets under management in those funds, and cause a commensurate decrease in the rate of growth of our management fees. Furthermore, it could significantly reduce the yield available for reinvesting capital received from prior investments, thereby reducing profits which would lead to a decrease in the incentive income earned by us. As a result of impairment recorded in connection with this market disruption, we will not earn incentive income from one of the Castles for an indeterminate period of time.

Investors in our hedge funds may redeem their investments and investors in our private equity funds may elect to dissolve the funds at any time without cause. These events would lead to a decrease in our revenues, which could be substantial and lead, therefore, 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 (e.g., a redeeming Drawbridge Special Opportunities Fund investor is not entitled to cash at the redemption date, but retains instead an interest in the investments as of the redemption date and receives monies from the fund only as

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and when such investments are realized). 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 which could result in investors leaving our funds include changes in interest rates that make other investments more attractive, the publicly traded nature of our manager, changes in investor perception regarding our focus or alignment of interest, unhappiness with changes in or broadening of a fund's investment strategy, changes in our reputation, and departures or changes in responsibilities of key investment professionals. In a declining financial market, the pace of redemptions and consequent reduction in our 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.

In addition, the investors in our private equity and domestic 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. 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 damages as well.

Many of our funds invest in relatively high-risk, illiquid assets that often have significantly leveraged capital structures, and we may fail to realize any profits from these activities for a considerable period of time or lose some or all of the principal amount we invest in these activities.

Many of our funds invest in securities that are not publicly traded. In many cases, our funds may be prohibited by contract or by applicable securities laws from selling such securities for a period of time. Our funds will generally not be able to sell these securities publicly unless their sale is registered under applicable securities laws, or unless an exemption from such registration requirements is available. Accordingly, our funds may be forced to sell securities at a loss, under certain conditions. The ability of many of our funds, particularly our private equity funds, to dispose of investments is heavily dependent on the public equity markets, inasmuch as our ability to realize any value from an investment may depend upon our ability to sell equity of the portfolio company in the public equity markets through an initial public offering (an ''IPO'') 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.

In addition, many of our funds, particularly our private equity funds, hybrid hedge funds and our Castles, 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 hedge funds are subject to risks due to potential illiquidity of assets.

Our hedge 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.

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The hedge 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.

The risks identified above will be increased if a fund is required to rapidly liquidate positions to meet 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 hedge 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 hedge 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, 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 hybrid hedge funds. The value of the investments of our funds is determined periodically by us based on the fair value of such investments. The fair value of investments is determined using a number of methodologies described in the funds' valuation policies. These policies are based on a number of factors, including the nature of the investment, the expected cash flows from the investment, bid or ask prices provided by third parties for the investment, the length of time the investment has been held, the trading price of securities (in the case of publicly traded securities), restrictions on transfer and other recognized valuation methodologies. The methodologies we use in valuing individual investments are based on a variety of estimates and assumptions specific to the particular investments, and actual results related to the investment therefore often vary materially as a result of the inaccuracy of such assumptions or estimates. In addition, because many of the illiquid investments held by our funds are in industries or sectors which are unstable, in distress, or undergoing some uncertainty, such investments are subject to rapid changes in value caused by sudden company-specific or industry-wide developments. In addition, in markets where transaction flow is limited due to uncertainty about accurate asset valuations or otherwise, hedge fund investors may become concerned about valuations of funds that have illiquid or hard-to-value assets, which may result in increased redemptions by investors irrespective of the performance of the funds.

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 will 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.

In some cases, the Fortress Funds realize value from an illiquid portfolio company when the portfolio company is able to sell equity in the public markets through an IPO. An IPO of a portfolio company increases the liquidity of the funds' investment in the company and can create significant value when the dividend yield on the company's shares after the IPO is lower than the return being generated by the company's net assets, thereby increasing the value of its equity. Therefore, Fortress

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values illiquid portfolio companies for which an IPO is being contemplated, or is in process, at fair value without regard to the theoretical value which may be created by the IPO, and such theoretical value may never be realized if the IPO is never consummated.

Certain of our funds utilize special situation and distressed debt investment strategies that involve significant risks.

Our private equity and hybrid hedge 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. In such situations, it may be difficult to obtain full information as to the exact financial and operating conditions of these obligors and issuers. Additionally, the fair values of such investments are subject to abrupt and erratic market movements and significant price volatility if they are publicly traded securities, and are subject to significant uncertainty in general if they are not publicly traded securities. Furthermore, some of our funds' distressed investments may not be widely traded or may have no recognized market. A fund's exposure to such investments may be substantial in relation to the market for those investments, and the assets are likely to be illiquid and difficult to sell or transfer. As a result, it may take a number of years for the fair value of such investments to ultimately reflect their intrinsic value as perceived by us.

A central feature of our distressed investment strategy is our ability to successfully predict the occurrence of certain corporate events, such as debt and/or equity offerings, restructurings, reorganizations, mergers, takeover offers and other transactions. If the corporate event we predict is delayed, changed or never completed, the market price and value of the applicable fund's investment could decline sharply.

If our risk management systems for our hedge fund business are ineffective, we may be exposed to material unanticipated losses.

In our hedge fund business, we continue to refine our risk management techniques, strategies and assessment methods. However, our risk management techniques and strategies do not fully mitigate the risk exposure of our funds in all economic or market environments, or against all types of risk, including risks that we might fail to identify or anticipate. Some of our strategies for managing risk in our funds are based upon our use of historical market behavior statistics. We apply statistical and other tools to these observations to measure and analyze the risks to which our funds are exposed. Any failures in our risk management techniques and strategies to accurately quantify such risk exposure could limit our ability to manage risks in the funds or to seek adequate risk-adjusted returns. In addition, any risk management failures could cause fund losses to be significantly greater than the historical measures predict. Further, our mathematical modeling does not take all risks into account. Our more qualitative approach to managing those risks could prove insufficient, exposing us to material unanticipated losses.

Some of our funds invest in foreign countries and securities of issuers located outside of the United States, which may involve foreign exchange, political, social and economic uncertainties and risks.

Some of our funds invest a portion of their assets in the equity, debt, loans or other securities of issuers located outside the U.S. In addition to business uncertainties, such investments may be affected by changes in exchange values as well as political, social and economic uncertainty affecting a country or region. Many financial markets are not as developed or as efficient as those in the U.S., and as a result, liquidity may be reduced and price volatility may be higher. The legal and regulatory environment may also be different, particularly with respect to bankruptcy and reorganization, and may afford us less protection as a creditor than we may be entitled to under U.S. law. Financial accounting standards and practices may differ, and there may be less publicly available information in respect of such companies.

Restrictions imposed or actions taken by foreign governments may adversely impact the value of our fund investments. Such restrictions or actions could include exchange controls, seizure or

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nationalization of foreign deposits and adoption of other governmental restrictions which adversely affect the prices of securities or the ability to repatriate profits on investments or the capital invested itself. Income received by our funds from sources in some countries may be reduced by withholding and other taxes. Any such taxes paid by a fund will reduce the net income or return from such investments. While our funds will take these factors into consideration in making investment decisions, including when hedging positions, no assurance can be given that the funds will be able to fully avoid these risks or generate sufficient risk-adjusted returns.

We are subject to risks in using prime brokers and custodians.

The funds in our liquid hedge funds business depend on the services of prime brokers and custodians to carry out certain securities transactions. In the event of the insolvency of a prime broker and/or custodian, the funds might not be able to recover equivalent assets in full as they will rank among the prime broker and custodian's unsecured creditors in relation to assets which the prime broker or custodian borrows, lends or otherwise uses. In addition, the funds' cash held with a prime broker or custodian will not be segregated from the prime broker's or custodian's own cash, and the funds will therefore rank as unsecured creditors in relation to the cash they have deposited.

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 holding shares 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 which would represent, after such issuance, or upon conversion, exchange or exercise, as the case may be, at least 10% of the total combined voting power of our outstanding Class A and Class B shares other than (1) pursuant to transactions solely among us and our wholly-owned subsidiaries, or (2) upon conversion of convertible securities or upon exercise of warrants or options, which convertible securities, warrants or options are either outstanding on the date of, or issued in compliance with, the shareholders agreement;

- investment of $250 million or greater: any equity or debt commitment or investment or series of related equity or debt commitments or investments in an entity or related group of entities in an amount greater than $250 million;
- new business requiring investment in excess of $100 million: any entry by us or any of our controlled affiliates into a new line of business that does not involve investment management and that requires a principal investment in excess of $100 million;

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- the adoption of a shareholder rights plan;
- any appointment of a chief executive officer or co-chief executive officer; or
- the termination of the employment of a principal with us or any of our material subsidiaries without cause.

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

In addition, our principals are entitled to a majority of our economic returns through their holdings of Fortress Operating Group units. Because they hold their economic interest in our business directly through Fortress Operating Group, rather than through the public company, our principals may have conflicting interests with holders of Class A shares. For example, our principals may have different tax positions from us which could influence their decisions regarding whether and when to dispose of assets, and whether and when to incur new or refinance existing indebtedness, especially in light of the existence of the tax receivable agreement. In addition, the structuring of future transactions may take into consideration the principals' tax considerations even where no similar benefit would accrue to us. Moreover, any distribution by the Fortress Operating Group to us to satisfy our tax obligations will result in a corresponding pro rata distribution to our principals.

We intend to pay regular dividends but our ability to do so 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 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. We intend to distribute quarterly dividends to our Class A shareholders. Accordingly, 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. 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 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. Moreover, we intend to distribute a portion of the incentive income that we receive as quarterly dividend payments to our Class A shareholders. Once we distribute such funds, we have no ability to recall the funds from our Class A shareholders and would, thus, be required to satisfy any subsequent clawback obligation using other sources. While the principals have personally guaranteed, subject to certain limitations, this ''clawback'' obligation, our shareholders agreement with them contains our agreement to indemnify the principals for all amounts which the principals pay pursuant to any of these personal guaranties in favor of our private equity funds. Consequently, any requirement to satisfy a clawback obligation could impair our ability to pay dividends on our Class A shares.

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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, we are permitted to make cash distributions subject to the following restrictions: (a) no event of default exists immediately prior to or subsequent to the distribution, (b) the amount of distributions over the prior 12 months do not exceed free cash flow (as defined in our credit agreement as net income plus (i) taxes, depreciation and private equity incentive income presented on an as-received basis less (ii) capital expenditures, permitted tax distributions and certain other adjustments) for the prior 12 month period, and (c) after giving effect to the distribution, we have cash on hand of not less than accrued but unpaid taxes (based on estimated entity level taxes due and payable by the Fortress Operating Group entities, primarily New York City unincorporated business tax) and amortization obligations (including scheduled principal payments) under the credit agreement which are required in the next 90 days. The events of default under the credit agreement are typical of such agreements and include payment defaults, failure to comply with credit agreement covenants, 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.

The cash reflected on our historical balance sheets for 2006 and earlier periods, which consolidates many of our funds, is not our cash and is not available to us; we depend on the cash we receive from the Fortress Operating Group.

Our historical combined financial information for 2006 and earlier periods includes significant balances of cash and restricted cash held at consolidated funds as assets on our balance sheet. Although the cash and other assets of certain Fortress Funds have historically been included in our assets on a consolidated basis for financial reporting purposes, such cash is not available to us to pay dividends or for other liquidity needs but rather is property of the relevant fund. Following changes to our fund documents that became effective on March 31, 2007, these funds are no longer consolidated, and such cash amounts are no longer included in our balance sheet assets. We depend on distributions from the Fortress Operating Group for cash. Although the Fortress Operating Group may borrow under our credit facility, it depends primarily on the management fees and incentive income it receives from the Fortress Funds and its portion of the distributions made by the Fortress Funds, if any, for cash.

Tax consequences to the principals may give rise to conflicts of interests.

As a result of unrealized built-in gain attributable to the value of our assets held by the Fortress Operating Group entities at the time of our initial public offering, upon the sale or, refinancing or disposition of the assets owned by the Fortress Operating Group entities, our principals will incur different and significantly greater tax liabilities as a result of the disproportionately greater allocations of items of taxable income and gain to the principals upon a realization event. As the principals will not receive a corresponding greater distribution of cash proceeds, they may, subject to applicable fiduciary or contractual duties, have different objectives regarding the appropriate pricing, timing and other material terms of any sale, refinancing, or disposition, or whether to sell such assets at all. Decisions made with respect to an acceleration or deferral of income or the sale or disposition of assets may also influence the timing and amount of payments that are received by an exchanging or selling principal under the tax receivable agreement. All other factors being equal, earlier disposition of assets following a transaction will tend to accelerate such payments and increase the present value of the tax receivable agreement, and disposition of assets before a transaction will increase a principal's tax liability without giving rise to any rights to receive payments under the tax receivable agreement. Decisions made regarding a change of control also could have a material influence on the timing and amount of payments received by the principals pursuant to the tax receivable agreement.

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We are required to pay our principals for most of the tax benefits we realize as a result of the tax basis step-up we receive in connection with taxable exchanges by our principals of units held in the Fortress Operating Group entities or our acquisitions of units from our principals.

At any time and from time to time, each principal has the right to exchange his Fortress Operating Group units for our Class A shares in a taxable transaction. These taxable exchanges, as well as our acquisitions of units from our principals, may result in increases in the tax depreciation and amortization deductions, as well as an increase in the tax basis of other assets, of the Fortress Operating Group that otherwise would not have been available. These increases in tax depreciation and amortization deductions, as well as the tax basis of other assets, may reduce the amount of tax that FIG Corp. or FIG Asset Co. LLC and any other corporate taxpayers would otherwise be required to pay in the future, although the IRS may challenge all or part of increased deductions and tax basis increase, and a court could sustain such a challenge.

We have entered into a tax receivable agreement with our principals that provides for the payment by the corporate taxpayers to our principals of 85% of the amount of tax savings, if any, that the corporate taxpayers actually realize (or are deemed to realize in the case of an early termination payment by the corporate taxpayers or a change of control, as discussed below) as a result of these increases in tax deductions and tax basis of the Fortress Operating Group. The payments that the corporate taxpayers may make to our principals could be material in amount.

Although we are not aware of any issue that would cause the IRS to challenge a tax basis increase, our principals will not reimburse the corporate taxpayers for any payments that have been previously made under the tax receivable agreement. As a result, in certain circumstances, payments could be made to our principals under the tax receivable agreement in excess of the corporate taxpayers' cash tax savings. The corporate taxpayers' ability to achieve benefits from any tax basis increase, and the payments to be made under this agreement, will depend upon a number of factors, including the timing and amount of our future income.

In addition, the tax receivable agreement provides that, upon a merger, asset sale or other form of business combination or certain other changes of control, the corporate taxpayers' (or their successors') obligations with respect to exchanged or acquired units (whether exchanged or acquired before or after such change of control) would be based on certain assumptions, including that the corporate taxpayers would have sufficient taxable income to fully utilize the deductions arising from the increased tax deductions and tax basis and other benefits related to entering into the tax receivable agreement.

If we were deemed an investment company under the Investment Company Act of 1940, applicable restrictions could make it impractical for us to continue our business as contemplated and could have a material adverse effect on our business and the price of our Class A shares.

We do not believe that we are an ''investment company'' under the Investment Company Act of 1940 because the nature of our assets and the sources of our income exclude us from the definition of an investment company pursuant to Rule 3a-1 under the Investment Company Act of 1940. In addition, we believe the company is not an investment company under Section 3(b)(1) of the Investment Company Act because it is primarily engaged in a non-investment company business. If one or more of the Fortress Operating Group entities ceased to be a wholly-owned subsidiary of ours, our interests in those subsidiaries could be deemed an ''investment security'' for purposes of the Investment Company Act of 1940. Generally, a person is an ''investment company'' if it owns investment securities having a value exceeding 40% of the value of its total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. We intend to conduct our operations so that we will not be deemed an investment company. However, if we were to be deemed an investment company, restrictions imposed by the Investment Company Act of 1940, including limitations on our capital structure and our ability to transact with affiliates, could make it impractical for us to continue our business as contemplated and would have a material adverse effect on our business and the price of our Class A shares.

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Risks Related To Our Class A Shares

An active market for our Class A shares may not be sustained.

Our Class A shares are listed on the New York Stock Exchange under the symbol ''FIG.'' However, we cannot provide any assurance that a regular trading market of our Class A shares will be sustained on that exchange or elsewhere. Accordingly, we cannot provide any assurance of the liquidity of any trading market, holders' ability to sell their Class A shares when desired, or at all, or the prices that they may obtain for their 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 and could be subject to wide fluctuations. In addition, the trading volume in our Class A shares may fluctuate and cause significant price variations to occur, which may limit or prevent investors from readily selling their Class A shares and may otherwise negatively affect the liquidity of our Class A shares. If the market price of our Class A shares declines significantly, holders may be unable to resell their Class A shares at or above their purchase price, if at all. We cannot provide any assurance that the market price of our Class A shares will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect the price of our Class A shares or result in fluctuations in the price or trading volume of our Class A shares include:

- variations in our quarterly operating results or dividends;
- failure to meet analysts' earnings estimates or failure to meet, or the lowering of, our own earnings guidance;
- publication of research reports about us 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;
- 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;
- adverse publicity about the asset management industry generally or individual scandals, specifically; and

• general market and economic conditions.

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

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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 November 13, 2007, we had 406,571,900 outstanding Class A shares on a fully diluted basis, 50,399,119 restricted Class A share units granted to employees (net of forfeitures) and 97,296 restricted Class A shares granted to directors pursuant to our equity incentive plan, and 64,503,585 Class A shares and Fortress Operating Group units that remain available for future grant under our equity incentive plan. Beginning in 2008, the Class A shares reserved under our equity incentive plan will be 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. 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.

Our principals own an aggregate of 312,071,550 Fortress Operating Group units. Each principal has the right to exchange each of his Fortress Operating Group units for one of our Class A shares at any time, subject to the Principals Agreement. Our principals, executive officers, directors and certain employees who received Class A shares and Fortress Operating Group units in connection with our initial public offering, Nomura and participants in our directed share program agreed with the underwriters not to dispose of or hedge any of our Class A shares, or Fortress Operating Group units, subject to specified exceptions, during the period from February 8, 2007 through June 8, 2007, except with the prior written consent of the representatives of the underwriters. This lock-up period has now expired. As a result, 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. Because the lock-up period has now expired, the principals currently have the ability to cause us to register the Class A shares they acquire upon exchange for their Fortress Operating Group units. Nomura will have the ability to cause us to register any of its 55,071,450 Class A shares beginning one year after its acquisition of Class A shares and may only transfer its Class A shares prior to such time to its controlled affiliates.

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

Our principals beneficially own all of our Class B shares. The principals' Class B shares will 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

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knowing violations of the law that are not done in good faith, (iii) improper redemption of shares or declaration of dividend, or (iv) a transaction from which the director or officer derived an improper personal benefit. In addition, our operating agreement provides that we indemnify our directors and officers for acts or omissions to the fullest extent provided by law. However, under the DGCL, a corporation can only indemnify directors and officers for acts or omissions if the director or officer acted in good faith, in a manner he reasonably believed to be in the best interests of the corporation, and, in a criminal action, if the officer or director had no reasonable cause to believe his conduct was unlawful. Accordingly, our operating agreement may be less protective of the interests of our Class A shareholders, when compared to the DGCL, insofar as it relates to the exculpation and indemnification of our officers and directors.

Risks Related to Taxation

Class A shareholders may be subject to U.S. federal income tax on their share of our taxable income, regardless of whether they receive any cash dividends from us.

So long as we are not required to register as an investment company under the Investment Company Act of 1940 and 90% of our gross income for each taxable year constitutes ‘‘qualifying income’’ within the meaning of the Internal Revenue Code of 1986, as amended (the ‘‘Code’’), on a continuing basis, we will be treated, for U.S. federal income tax purposes, as a partnership and not as an association or a publicly traded partnership taxable as a corporation. Class A shareholders may be subject to U.S. federal, state, local and possibly, in some cases, foreign income taxation on their allocable share of our items of income, gain, loss, deduction and credit (including our allocable share of those items of any entity in which we invest that is treated as a partnership or is otherwise subject to tax on a flow through basis) for each of our taxable years ending with or within their taxable year, regardless of whether or not they receive cash dividends from us. They may not receive cash dividends equal to their allocable share of our net taxable income or even the tax liability that results from that income. In addition, certain of our holdings, including holdings, if any, in a Controlled Foreign Corporation (‘‘CFC’’) and a Passive Foreign Investment Company (‘‘PFIC’’), may produce taxable income prior to the receipt of cash relating to such income, and holders of our Class A shares will be required to take such income into account in determining their taxable income. Under our operating agreement, in the event of an inadvertent partnership termination in which the Internal Revenue Service (‘‘IRS’’) has granted us limited relief, each holder of our Class A shares also is obligated to make such adjustments as are required by the IRS to maintain our status as a partnership. Such adjustments may require persons who hold our Class A shares to recognize additional amounts in income during the years in which they hold such shares. We may also be required to make payments to the IRS.

Our intermediate holding company, FIG Corp., is subject to corporate income taxation in the United States, and we may be subject to additional taxation in the future.

A significant portion of our investments and activities may be made or conducted through FIG Corp. Dividends paid by FIG Corp. from time to time will, as is usual in the case of a U.S. corporation, then be included in our income. Income received as a result of investments made or activities conducted through FIG Asset Co. LLC (but excluding through its taxable corporate affiliates) is not subject to corporate income 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

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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 and we cannot provide any assurance that we will in fact pay cash dividends as currently intended. In particular, the amount and timing of dividends will depend upon a number of factors, including, among others:

- our actual results of operations and financial condition;
- restrictions imposed by our operating agreement or applicable law;
- restrictions imposed by our credit agreements;
- reinvestment of our capital;
- the timing of the investment of our capital;
- the amount of cash that is generated by our investments or to fund liquidity needs;
- levels of operating and other expenses;
- contingent liabilities; or
- factors that our board of directors deems relevant.

Even if we do not distribute cash in an amount that is sufficient to fund a shareholder's tax liabilities, they will still be required to pay income taxes on their share of our taxable income.

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

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in a material adverse effect on our cash flow and the after-tax returns for holders of Class A shares and thus could result in a substantial reduction in the value of the Class A shares.

Our structure involves complex provisions of U.S. federal income tax law for which no clear precedent or authority may be available. Our structure also is subject to potential legislative, judicial or administrative change and differing interpretations, possibly on a retroactive basis.

The U.S. federal income tax treatment of holders of the Class A shares depends in some instances on determinations of fact and interpretations of complex provisions of U.S. federal income tax law for which no clear precedent or authority may be available. Readers should be aware that the U.S. federal income tax rules are constantly under review by persons involved in the legislative process, the IRS, and the U.S. Treasury Department, frequently resulting in revised interpretations of established concepts, statutory changes, revisions to regulations and other modifications and interpretations. The IRS pays close attention to the proper application of tax laws to partnerships. The present U.S. federal income tax treatment of an investment in the Class A shares may be modified by administrative, legislative or judicial interpretation at any time, possibly on a retroactive basis, and any such action may affect investments and commitments previously made. For example, changes to the U.S. federal tax laws and interpretations thereof could make it more difficult or impossible to meet the qualifying income exception for us to be treated as a partnership for U.S. federal income tax purposes that is not taxable as a corporation, affect or cause us to change our investments and commitments, change the character or treatment of portions of our income (including, for instance, treating carried interest as ordinary fee income rather than capital gain) affect the tax considerations of an investment in us and adversely affect an investment in our Class A shares.

Our organizational documents and agreements permit the board of directors to modify our operating agreement from time to time, without the consent of the holders of Class A shares, in order to address certain changes in U.S. federal income tax regulations, legislation or interpretation. In some circumstances, such revisions could have a material adverse impact on some or all of the holders of our Class A shares. Moreover, we will apply certain assumptions and conventions in an attempt to comply with applicable rules and to report income, gain, deduction, loss and credit to holders in a manner that reflects such holders' beneficial ownership of partnership items, taking into account variation in ownership interests during each taxable year because of trading activity. However, these assumptions and conventions may not be in compliance with all aspects of applicable tax requirements. It is possible that the IRS will assert successfully that the conventions and assumptions used by us do not satisfy the technical requirements of the Code and/or Treasury regulations and could require that items of income, gain, deductions, loss or credit, including interest deductions, be adjusted, reallocated, or disallowed, in a manner that adversely affects holders of the Class A shares.

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.

On June 14, 2007, legislation was introduced in the Senate that would tax as corporations publicly traded partnerships that directly or indirectly derive income from investment adviser or asset management services. In addition, the Chairman and the Ranking Republican Member of the Senate Committee on Finance concurrently issued a press release stating that they do not believe that proposed public offerings of private equity and hedge fund management firms are consistent with the intent of the existing rules regarding publicly traded partnerships because the majority of their income is from the active provision of services to investment funds and limited partner investors in such funds. As explained in the technical explanation accompanying the proposed legislation:

Under the bill, the exception from corporate treatment for a publicly traded partnership does not apply to any partnership that, directly or indirectly, has any item of income or gain (including capital gains or dividends), the rights to which are derived from services provided by any person as an investment adviser, as defined in the Investment Advisers Act of 1940,

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or as a person associated with an investment adviser, as defined in that Act. Further, the exception from corporate treatment does not apply to a partnership that, directly or indirectly, has any item of income or gain (including capital gains or dividends), the rights to which are derived from asset management services provided by an investment adviser, a person associated with an investment adviser, or any person related to either, in connection with the management of assets with respect to which investment adviser services were provided.

If enacted in its proposed form, the transition rules of the proposed legislation would delay the application of these rules for five years. Legislation also has been introduced that is substantially similar to the proposed legislation introduced in the Senate that would apply the legislation to us with respect to our 2008 taxable year. In addition, legislation has been introduced in the House, and passed by the House Ways and Means Committee, that would have the effect of treating income recognized from ‘‘carried interests’’ as ordinary fee income, thereby effectively causing such income to be treated as nonqualifying income under the publicly traded partnership rules, which would preclude us qualifying for treatment as a partnership for U.S. federal income tax purposes. The proposal did not discuss transition relief.

If any version of these legislative proposals were to be enacted into law, or if other similar legislation were to be 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, holders 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.

FIG Asset Co. LLC may not be able to invest in certain assets, other than through a taxable corporation.

In certain circumstances, FIG Asset Co. LLC or one of its subsidiaries may have an opportunity to invest in certain assets through an entity that is characterized as a partnership for U.S. federal income tax purposes, where the income of such entity may not be ‘‘qualifying income’’ for purposes of the publicly traded partnership rules. In order to manage our affairs so that we will meet the qualifying income exception, we may either refrain from investing in such entities or, alternatively, we may structure our investment through an entity classified as a corporation for U.S. federal income tax purposes. If the entity were a U.S. corporation, it would be subject to U.S. federal income tax on its operating income, including any gain recognized on its disposal of its interest in the entity in which the opportunistic investment has been made, as the case may be, and such income taxes would reduce the return on that investment.

Complying with certain tax-related requirements may cause us to forego otherwise attractive business or investment opportunities or enter into acquisitions, borrowings, financings or arrangements we may not have otherwise entered into.

In order for us to be treated as a partnership for U.S. federal income tax purposes, and not as an association or publicly traded partnership taxable as a corporation, we must meet the qualifying income exception discussed above on a continuing basis and we must not be required to register as an investment company under the Investment Company Act of 1940. In order to effect such treatment we (or our subsidiaries) may be required to invest through foreign or domestic corporations, forego attractive business or investment opportunities or enter into borrowings or financings we may not have otherwise entered into. This may adversely affect our ability to operate solely to maximize our cash flow. Our structure also may impede our ability to engage in certain corporate acquisitive transactions because we generally intend to hold all of our assets through the Fortress Operating Group. In addition, we may be unable to participate in certain corporate reorganization transactions that would be tax free to our holders if we were a corporation. To the extent we hold assets other than through the Fortress Operating Group, we will make appropriate adjustments to the Fortress Operating Group agreements so that distributions to principals and us would be the same as if such assets were held at that level.

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The IRS could assert that we are engaged in a U.S. trade or business, with the result that some portion of our income is properly treated as effectively connected income with respect to non-U.S. holders. Moreover, certain REIT dividends and other stock gains may be treated as effectively connected income with respect to non-U.S. holders.

While we expect that our method of operation will not result in a determination that we are engaged in a U.S. trade or business, there can be no assurance that the IRS will not assert successfully that we are engaged in a U.S. trade or business, with the result that some portion of our income is properly treated as effectively connected income with respect to non-U.S. holders.

Moreover, dividends paid by an investment that we make in a REIT that is attributable to gains from the sale of U.S. real property interests will, and sales of certain investments in the stock of U.S. corporations owning significant U.S. real property may, be treated as effectively connected income with respect to non-U.S. holders. To the extent our income is treated as effectively connected income, non-U.S. holders generally would be subject to withholding tax on their allocable shares of such income, would be required to file a U.S. federal income tax return for such year reporting their allocable shares of income effectively connected with such trade or business, and would be subject to U.S. federal income tax at regular U.S. tax rates on any such income. Non-U.S. holders may also be subject to a 30% branch profits tax on such income in the hands of non-U.S. holders that are corporations.

An investment in Class A shares will give rise to UBTI to certain tax-exempt holders.

We will not make investments through taxable U.S. corporations solely for the purpose of limiting unrelated business taxable income, or UBTI, from ‘‘debt-financed’’ property and, thus, an investment in Class A shares will give rise to UBTI to certain tax-exempt holders. For example, FIG Asset Co. LLC will invest in or hold interests in entities that are treated as partnerships, or are otherwise subject to tax on a flow-through basis, that will incur indebtedness. FIG Asset Co. LLC may borrow funds from FIG Corp. or third parties from time to time to make investments. These investments will give rise to UBTI from ‘‘debt-financed’’ property. However, we expect to manage our activities to avoid a determination that we are engaged in a trade or business, thereby limiting the amount of UBTI that is realized by tax-exempt holders of our Class A shares.

We may hold or acquire certain investments through an entity classified as a PFIC or CFC for U.S. federal income tax purposes.

Certain of our investments may be in foreign corporations or may be acquired through a foreign subsidiary that would be classified as a corporation for U.S. federal income tax purposes. Such an entity may be a PFIC or a CFC for U.S. federal income tax purposes. U.S. holders of Class A shares indirectly owning an interest in a PFIC or a CFC may experience adverse U.S. tax consequences.

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

Use of Proceeds from Initial Public Offering

On February 8, 2007, Fortress Investment Group LLC completed an initial public offering of 39,428,900 of its Class A shares, including those shares sold pursuant to the exercise of the underwriters' over-allotment option, at a price of $18.50 per share. Fortress Investment Group LLC sold all of the shares offered, for which it received net proceeds of approximately $652.7 million, which is net of the underwriters' discount of approximately $43.8 million and other expenses. The Class A shares sold in the offering were registered under the Securities Act on a registration statement on Form S-1 (No. 333-138514) that was declared effective by the SEC on February 8, 2007. Public trading on the common stock commenced on February 9, 2007. The managing underwriters for the initial public offering were Goldman, Sachs & Co. and Lehman Brothers Inc.

Upon consummation of the offering, Fortress Investment Group LLC contributed the net proceeds from the offering to Fortress Operating Group in exchange for 39,428,900 limited partnership units. As of September 30, 2007, Fortress Operating Group had applied these proceeds in accordance with its IPO registration statement as follows: (a) to pay $250 million then outstanding under the term loan facility of our 2006 Credit Agreement, as required by that credit agreement, (b) to pay $85 million then outstanding under the revolving credit facility of our 2006 Credit Agreement, (c) to fund $169 million of commitments to private equity funds, and (d) to fund $149 million of general business purposes, including additional investments.

Item 3. Defaults upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

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Item 6. Exhibits

(a) and (c) Financial statements and schedules:

See ‘‘Financial Statements’’

(b) Exhibits filed with this 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 Second Amended and Restated Limited Liability Agreement of the Registrant (incorporated by reference to the Registrant’s Registration Statement on Form S-1 (File No. 333-138514), Exhibit 3.3). 10 .1 Second Amended and Restated Credit Agreement, dated as of May 10, 2007, among FIG LLC and certain of its Affiliates, as Borrowers; certain subsidiaries and Affiliates, as Guarantors; Bank of America, N.A., as Administrative Agent; Bank of America, N.A., Citibank, N.A., Deutsche Bank AG, New York Branch, Goldman Sachs Credit Partners L.P., Lehman Commercial Paper Inc., Wells Fargo Bank, National Association, and JPMorgan Chase Bank, N.A., as Lenders (incorporated by reference to the Registrant’s Current Report on Form 8-K, filed with the SEC on May 14, 2007 (File No. 001-33294), Exhibit 10.1). 10 .2 First Amendment to the Second Amended and Restated Credit Agreement, dated as of May 10, 2007, among FIG LLC and certain of its Affiliates, as Borrowers; certain subsidiaries and Affiliates, as Guarantors; Bank of America, N.A., as Administrative Agent; Bank of America, N.A., Citibank, N.A., Deutsche Bank AG, New York Branch, Goldman Sachs Credit Partners L.P., Lehman Commercial Paper Inc., Wells Fargo Bank, National Association and JPMorgan Chase Bank, N.A., as Lenders. 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.

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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 13, 2007 By: /s/ Wesley R. Edens Wesley R. Edens
Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following person on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Wesley R. Edens
Wesley R. Edens
Chief Executive Officer

November 13, 2007

By: /s/ Daniel N. Bass
Daniel N. Bass
Chief Financial Officer

November 13, 2007

By: /s/ Jonathan R. Brown
Jonathan R. Brown
Chief Accounting Officer

November 13, 2007