Fortress International Group, Inc.
Form 10-Q
August 14, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

or

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

Commission file number: 000-51426

FORTRESS INTERNATIONAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-2027651**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
7226 Lee DeForest Drive, Suite 104 Columbia, Maryland	**21046**
(Address of principal executive offices)	(Zip Code)

(410) 423-7300

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

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

Common Stock, par value $0.0001 per share, as of July 31, 2012	**14,729,520**

FORTRESS INTERNATIONAL GROUP, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FORTRESS INTERNATIONAL GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited) June 30, 2012	December 31, 2011
Assets		
Current Assets		
Cash and cash equivalents	$5,721,339	$6,731,487
Contract and other receivables, net	10,375,132	7,147,714
Costs and estimated earnings in excess of billings on uncompleted contracts	809,395	2,729,424
Prepaid expenses and other current assets	668,817	497,712
Total current assets	17,574,683	17,106,337
Property and equipment, net	394,573	305,463
Goodwill	1,768,861	3,839,861
Other intangible assets, net	60,000	60,000
Other assets	22,515	20,975
Total assets	$19,820,632	$21,332,636
Liabilities and Stockholders' Equity		
Current Liabilities		
Convertible notes, current portion	$500,000	$375,000
Accounts payable and accrued expenses	7,919,649	6,886,094
Billings in excess of costs and estimated earnings on uncompleted contracts	3,738,281	2,819,368
Total current liabilities	12,157,930	10,080,462
Convertible notes, less current portion	2,207,301	2,457,301
Other liabilities	67,397	76,073
Total liabilities	14,432,628	12,613,836
Commitments and Contingencies	-	-
Stockholders' Equity		
Preferred stock- $.0001 par value; 1,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock- $.0001 par value, 49,000,000 shares authorized; 14,896,355 and 14,749,356 issued; 14,149,107 and 14,028,407 outstanding at June 30, 2012 and December 31, 2011, respectively	1,488	1,475
Additional paid-in capital	66,011,767	65,805,358
	(1,466,670)	(1,450,455)

Treasury stock 747,248 and 720,949 shares at cost at June 30, 2012 and December 31, 2011, respectively		
Accumulated deficit	(59,158,581)	(55,637,578)
Total stockholders' equity	5,388,004	8,718,800
Total liabilities and stockholders’ equity	$19,820,632	$21,332,636

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

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FORTRESS INTERNATIONAL GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	(Unaudited) For the Three Months Ended		(Unaudited) For the Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Results of Operations:				
Revenue	$ 15,540,852	$ 10,515,498	$ 29,850,714	$ 20,130,427
Cost of revenue, excluding depreciation and amortization	13,209,463	6,614,311	25,464,820	12,093,169
Gross profit, excluding depreciation and amortization	2,331,389	3,901,187	4,385,894	8,037,258
Operating expenses:				
Selling, general and administrative	2,399,501	2,795,556	5,307,136	5,830,167
Restructuring and other charges	-	-	279,286	-
Depreciation and amortization	81,356	57,798	158,261	120,498
Impairment loss on goodwill	2,071,000	-	2,071,000	-
Total operating costs	4,551,857	2,853,354	7,815,683	5,950,665
Operating (loss) income	(2,220,468)	1,047,833	(3,429,789)	2,086,593
Interest income (expense), net	(48,446)	(4,422)	(91,214)	(21,255)
Other income (expense), net	-	919,084	-	919,084
(Loss) income before income taxes	(2,268,914)	1,962,495	(3,521,003)	2,984,422
Income tax expense	-	-	-	-
Net (loss) income	$ (2,268,914)	$ 1,962,495	$ (3,521,003)	$ 2,984,422
Basic (Loss) Earnings per Share:				
(Loss) earnings per common share	$ (0.16)	$ 0.15	$ (0.25)	$ 0.22
Weighted average common shares outstanding	14,147,049	13,456,310	14,124,380	13,427,997
Diluted (Loss) Earnings per Share:				
(Loss) earnings per common share	$ (0.16)	$ 0.13	$ (0.25)	$ 0.21
Weighted average common shares outstanding	14,147,049	14,899,608	14,124,380	14,828,141

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

FORTRESS INTERNATIONAL GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	(Unaudited) For the Six Months Ended	
	June 30, 2012	June 30, 2011
Cash Flows from Operating Activities:		
Net (loss) income	$ (3,521,003)	$ 2,984,422
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	158,261	120,498
Provision for doubtful accounts	55,290	90,000
Stock-based compensation	206,422	342,183
Impairment loss on goodwill	2,071,000	-
Other non cash items	-	(78,944)
Changes in operating assets and liabilities:		
Contracts and other receivables	(3,282,708)	1,490,248
Costs and estimated earnings in excess of billings on uncompleted contracts	1,920,029	78,289
Prepaid expenses and other current assets	(171,105)	(199,621)
Other assets	(1,540)	7,432
Accounts payable and accrued expenses	1,033,555	(4,820,075)
Billings in excess of costs and estimated earnings on uncompleted contracts	918,913	(3,472,601)
Other liabilities	(8,676)	(30,984)
Net cash used in operating activities	(621,562)	(3,489,153)
Cash Flows from Investing Activities:		
Purchase of property and equipment	(247,371)	(75,352)
Proceeds from repayment of note in connection with the sale of substantially all assets and liabilities of Rubicon	-	90,341
Net cash (used in) provided by investing activities	(247,371)	14,989
Cash Flows from Financing Activities:		
Payment on seller notes	(125,000)	(180,000)
Purchase of treasury stock	(16,215)	(51,861)
Net cash used in financing activities	(141,215)	(231,861)
Net decrease in cash	(1,010,148)	(3,706,025)
Cash and cash equivalents, beginning of period	6,731,487	10,980,420
Cash and cash equivalents, end of period	$ 5,721,339	$ 7,274,395
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 28,323	$ 107,910
Cash paid for taxes	$ 8,001	$ -
Supplemental disclosure of non-cash operating activities		
Interest forgiveness in settlement of SMLB seller notes	$ -	$ 25,310
Supplemental disclosure of non-cash financing activities		
Principal forgiveness in settlement of SMLB seller notes	$ -	$ 20,572

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

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FORTRESS INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The unaudited condensed consolidated financial statements are as of June 30, 2012 and December 31, 2011 and for the three and six months ended June 30, 2012 and 2011 for Fortress International Group, Inc. (“Fortress” or the “Company” or “We”).

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and note disclosures normally included in the annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”), have been condensed or omitted pursuant to those rules and regulations. We recommend that you read these unaudited condensed consolidated financial statements in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2011, previously filed with the SEC. We believe that the unaudited condensed consolidated financial statements in this Quarterly Report on Form 10-Q reflect all adjustments that are necessary to fairly present the financial position, results of operations and cash flows for the interim periods presented. The results of operations for such interim periods are not necessarily indicative of the results that can be expected for the full year.

Overview

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

The Company’s focus is centered on growing profitability and corresponding cash flow. On an ongoing basis, the Company works to increase sales, project utilization and align selling, general and administrative expenses with sales through cost cutting measures. We will continue to closely monitor our costs relative to actual and anticipated revenues and may make further reductions to selling, general and administrative expenses including but not limited to personnel and related costs and marketing.

During the first quarter 2012, as a result of the decline in its profitability, the Company failed to comply with certain financial covenants under its revolving line of credit facility (Credit Agreement), which was then terminated June 28, 2012. At the time of termination of the Credit Agreement, Borrowers had no outstanding borrowings under the Credit Agreement. No penalties, fees, charges or assessments were due to the lender in connection with the termination of the Credit Agreement. The Company believes that the termination of the Credit Agreement will not have a material adverse effect on the Company's business, operating results, and financial condition and that the Company's current cash and cash equivalents and expected future cash generated from operations will satisfy over the next twelve months the expected working capital, capital expenditure, and financing obligations of the Company (see Note 9).

The Company had $5.7 million and $6.7 million of unrestricted cash and cash equivalents at June 30, 2012 and December 31, 2011, respectively. During the six months ended June 30, 2012, the Company financed its operations through its cash balances and working capital. As a result of efforts to align and monitor operating costs with anticipated revenues, management believes that the Company’s current cash and cash equivalents and expected future cash generated from operations will satisfy the expected working capital, capital expenditure and financial service requirements of the Company’s current business through the next twelve months.

Recently Issued Accounting Pronouncements

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

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

FORTRESS INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(2) Contract and Other Receivables, net

The Company had an allowance for doubtful accounts of $0.1 million at June 30, 2012 and December 31, 2011. Bad debt expense for the three months ended June 30, 2012 and 2011 was $55,290 and $30,000, respectively.

Included in accounts receivable was retainage associated with construction projects totaling $0.8 million and $0.2 million at June 30, 2012 and December 31, 2011, respectively.

The Company earned approximately 46% and 42% of its revenue from two customers for both the three months ended June 30, 2012 and 2011. The Company earned approximately 41% and 42% of its revenue from one and two customers for the six months ended June 30, 2012 and 2011, respectively. Accounts receivable from these two customers at June 30, 2012 and December 31, 2011 were $4.6 million and $0.7 million, respectively.

Additionally, two customers comprising 41% of the Company's total revenue for the three and six months ended June 30, 2011 were purchased in 2010. While we continue to pursue work with these customers, we recorded no revenue for the three and six months ended June 30, 2012 from them.

Under certain construction management contracts, the Company is obligated to obtain performance bonds with various financial institutions, which typically require a security interest in the corresponding receivable. At June 30, 2012 and December 31, 2011, bonds outstanding that are secured by specific project accounts receivable totaled $17.9 million.

(3) Accounts Payable and Accrued Expenses

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

	June 30, 2012	December 31, 2011
Accounts payable	$ 4,794,698	$ 3,858,251
Accounts payable retainage	552,689	201,331

Accrued project costs	1,704,383	1,927,439
Restructuring liability	162,631	-
Other accrued expenses	705,248	899,073
Total accounts payable and accrued expenses	$ 7,919,649	$ 6,886,094

In an effort to align the Company's resources with anticipated types of services and volume, during the six months ended June 30, 2012 the Company adopted a restructuring plan that included a reduction in employee work force by 18 employees. The restructuring plan resulted in a restructuring charge in the amount of $0.3 million, which is principally related to estimated employee severance, stock based compensation and post-employment health care costs to be paid by the Company in connection with implementing the restructuring plan. During the three and six months ended June 30, 2012, the Company made cash payments totaling $62,000 and $88,000, respectively. No such charges were recorded in the prior year.

(4) Goodwill

The Company evaluates goodwill for impairment between annual tests if indicators of impairment exist. During the three months ended June 30, 2012 the overall market capitalization value of the Company declined from the closing price at March 31, 2012. This decline was deemed a circumstance of possible goodwill impairment that required a goodwill impairment evaluation sooner than the required annual evaluation in the fourth quarter of 2012. For this evaluation, the Company as a whole is considered the reporting unit. Based on the requirements of ASC 350, *Intangibles-Goodwill and Other*, the Company determined the carrying value of the reporting unit exceeded the fair value, resulting in an impairment loss on goodwill in the amount of $2.1 million during the three months ended June 30, 2012. The income and market approach were used in determining the fair value of the reporting unit with a significant weighting placed on the market value due to the changing nature of the Company's business.

At June 30, 2012 and December 31, 2011, the adjusted carrying value of goodwill was as follows:

	June 30, 2012	December 31, 2011
Gross carrying amount of goodwill	$20,016,727	$20,016,727
Accumulated impairment loss on goodwill	(18,247,866)	(16,176,866)
Net goodwill	$1,768,861	$3,839,861

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FORTRESS INTERNATIONAL GROUP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(5) Basic and Diluted (Loss) Earnings per Share

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

	Three Months Ended June 30,					
	2012			2011		
	Loss	Shares	$ per Share	Income	Shares	$ per Share
BASIC (LOSS) EARNINGS PER SHARE						
Net (loss) income	$(2,268,914)	14,147,049	$(0.16)	$1,962,495	13,456,310	$0.15
EFFECT OF DILUTIVE SECURITIES						
Unvested restricted stock	-	-	-	-	1,065,658	(0.01)
Unsecured convertible note	-	-	-	28,323	377,640	(0.01)
DILUTED (LOSS) EARNINGS PER SHARE	$(2,268,914)	14,147,049	$(0.16)	$1,990,818	14,899,608	$0.13

	Six months ended June 30,					
	2012			2011		
	Loss	Shares	$ per Share	Income	Shares	$ per Share
BASIC (LOSS) EARNINGS PER SHARE						