FORTRESS PAPER LTD.

Q1 2011

FOR THE THREE MONTHS ENDED

MARCH 31, 2011

FORTRESS PAPER LTD.
MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations of Fortress Paper Ltd. ("Fortress" or the "Company") has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the company has commenced reporting on this basis and this MD&A should be read in conjunction with the unaudited consolidated financial statements and the notes thereto for the three month period ended March 31, 2011 (available on SEDAR at www.sedar.com). The MD&A provides a review of the significant developments that have impacted the Company's performance during the quarter ended March 31, 2011 relative to the previous quarter and prior year comparative quarter.

This MD&A contains certain forward-looking statements that reflect the current views and/or expectations of the Company with respect to its performance, business and future events. The reader is cautioned that forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements including, without limitation, those relating to damage to our reputation, competition, maintaining our market position, marketability and price of our products, technology and protection of our intellectual property, dependence on our major customers, fluctuations in the price and supply of raw materials, fluctuations in foreign exchange and other risk factors detailed in our filings with Canadian securities regulatory authorities. These risks, as well as others, could cause actual results and events to vary significantly. The Company does not undertake any obligation to release publicly any revisions for updating any voluntary forward-looking statements, except as required by law.

Throughout this discussion, reference is also made to EBITDA (defined as net income before interest, income taxes, depreciation, amortization, non-operating income and expenses and stock based compensation), which the Company considers to be an indicative measure of operating performance and a good metric to evaluate profitability. Reference is also made to Adjusted Net Income (Loss) (calculated as Net Income (Loss) less specific items affecting comparability with prior periods) and Adjusted Net Income (Loss) per Share (calculated as Adjusted Net Income (Loss) divided by the weighted average number of shares outstanding in the period). EBITDA, Adjusted Net Income (Loss) and Adjusted Net Income (Loss) per Share are not generally accepted earnings measures and should not be considered as an alternative to net income or cash flows as determined in accordance with Canadian GAAP. As there is no standardized method of calculating these measures, the Company's EBITDA, Adjusted Net Income (Loss) and Adjusted Net Income (Loss) per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of EBITDA and Adjusted Net Income (Loss) to net income (loss) reported in accordance with GAAP are included in this MD&A.

The information in this report is as at June 8, 2011.

Description of Business

The Company was incorporated on May 30, 2006 under the laws of the Province of British Columbia. Fortress Paper Ltd. is an international producer of security and other specialty papers and products. The Company owns and operates three mills, the Landqart mill located in Switzerland, the Dresden mill located in Germany and the Fortress Specialty Cellulose mill located in Quebec, Canada. Fortress' security papers include banknote, passport, visa papers and security threads. The security papers produced at the Landqart mill incorporate internationally recognized overt and covert security features which are embedded into the paper and supplemented with customer-specific features. The Landqart mill has leveraged its extensive security papers competence to develop additional commercial applications using its in-house know-how and technology of security features to create innovative paper-based security products ("Security and Specialty Paper Segment"). The Landqart mill also produced specialty papers including non-woven wallpaper base, graphic and technical papers. The final sale of specialty papers was made in the first quarter of 2011. The Dresden mill produces coated and uncoated wallpaper base for wallpaper manufacturers ("Wallpaper Base Papers Segment"). Fortress Paper's pulp business ("Pulp Segment") includes northern bleached hardwood kraft ("NBHK") produced at the Fortress Specialty Cellulose mill currently in process of converting this capacity into dissolving pulp production along with the construction of a biomass based cogeneration plant. The segmentation of the Company's manufacturing operations is based on a number of factors, including production, production processes, and economic characteristics.

Highlights

Fortress reported 2011 first quarter EBITDA of $1.0 million. For the three months ended March 31, 2010 EBITDA was $5.1 million and for the fourth quarter of 2010 EBITDA was $3.6 million.

Fortress reported adjusted net loss of $5.6 million for the first quarter of 2011 on sales of $85.5 million or loss per share of $0.43. For the first quarter of 2010 the Company report adjusted net income of $2.3 million or diluted adjusted earnings per share of $0.22 on sales of $50.3 million. In the fourth quarter of 2010 the Company reported adjusted net loss of $1.0 million on sales of $83.5 million or adjusted loss per share of $0.07.

The Security and Specialty Paper Segment experienced a challenging first quarter of 2011 which materially impacted the Company's results. High raw material prices combined with industry over-capacity due in part to postponements of several major new currency launches has contributed to the negative results in this segment.

The Wallpaper Segment produced its best quarterly result. Sales were strong throughout the quarter and margins remained stable.

The Pulp Segment continues to produce NBHK and had comparable results to fourth quarter of 2010. The shut-down of the mill for conversion to dissolving pulp is scheduled for late third quarter 2011. Dissolving pulp sales are anticipated to provide significantly higher margins than NBHK sales.

In the first quarter of 2011, Fortress completed the acquisition of the assets of the Bank of Canada's Optical Security Material (OSM) division (the "OSM Assets"), which produces the optically variable material for the security threads contained in various banknotes, including application in the Canadian banknotes. The Company paid a purchase price of $0.75 million for the OSM assets and granted the Bank of Canada a royalty-free license to use the intellectual property sold to the Company for Canadian banknote applications.

In February of 2011, Fortress completed a public offering of 967,000 common shares of the Company and the underwriters exercised their over-allotment option and purchased an additional 145,050 common shares at a price of $51.75 per share, resulting in aggregate gross proceeds under the offering of $57.5 million. Proceeds of the offering are being used to finance certain capital expenditures relating to its Fortress Specialty Cellulose Mill in Thurso, Quebec and the construction of a high security facility adjacent to the Fortress Specialty Cellulose Mill which will house the Company's OSM Assets recently acquired from the Bank of Canada, and for working capital and general corporate purposes.

Also in the quarter, Fortress' wholly-owned subsidiary Dresden Papier GmbH ("Dresden") increased the current credit facility amounting to EUR18.5 million to EUR 22.15 million for the rebuild of Landqart's PM1 into a banknote paper-machine.

The remaining $7 million principal amount of the Company's $15 million unsecured convertible debenture that was issued on April 30, 2010 has been converted. The Company has issued 350,000 common shares with this redemption.

Management's Outlook

At Landqart, the Company completed the successful transformation of PM1 to a high security paper-machine and began production of bank note papers on the new machine. The rebuilt PM1 allows the Company to consolidate bank note and high security papers production on PM1 and significantly improve overall production efficiency. By consolidating production of bank note and security papers into PM1, the Landqart mill has temporarily suspended the commercial operation of paper machine number 2 and will utilize it only for trials and sample production until such time as this additional capacity is required. The plan to improve our production efficiency has resulted in a reduction of our overall labour requirements. The full impact of the plan to improve overall efficiency will be realized in the fourth quarter of 2011. With escalating raw material costs in cotton and over capacity due to the postponement of implementation of several major currencies, 2011 will be a challenging year for Landqart and the banknote industry.

The results at Fortress Specialty Cellulose reflect weakening NBHK prices that have come off their peaks reached in 2010 and a strengthening Canadian dollar. The shut-down of the mill for conversion to dissolving pulp is scheduled for late third quarter 2011. The underlying markets for dissolving pulp remain strong which continues to provide management with conviction in our attempts to expand further in this business segment.

At our Dresden operations, the order log continues to show strength and the mill productivity and profitability has exceeded management's expectations.

First Quarter 2011 Earnings Review

Three Months Ended March 31, 2011

Overview

Fortress reported 2011 first quarter EBITDA of $1.0 million. For the three months ended March 31, 2010 EBITDA was $5.1 million and for the fourth quarter of 2010 EBITDA was $3.6 million.

Fortress reported adjusted net loss of $5.6 million for the first quarter of 2011 on sales of $85.5 million or loss per share of $0.43. For the first quarter of 2010 the Company reported adjusted net income of $2.3 million or diluted adjusted earnings per share of $0.22 on sales of $50.3 million. In the fourth quarter of 2010 the Company reported adjusted net loss of $1.0 million on sales of $83.5 million or adjusted loss per share of $0.07.

Analysis of Specific Items Affecting Comparability of Net Income

(thousands of dollars, except per share figures, unaudited)	**Q1 2011**	**Q4 2010**	**Q1 2010**
Net (loss) income as reported	(5,727)	(12,790)	(397)
Foreign exchange loss (gain)	122	513	2,073
Executive Award	-	10,556	-
Write down at Landqart of PM1 legacy assets	-	792	-
Deferred expenses written off	-	-	576
Adjusted net (loss) income	(5,605)	(929)	2,252
Net (loss) income per share	(0.43)	(1.01)	(0.04)
Adjusted net (loss) income per share	(0.42)	(0.07)	0.22

Cost of products sold were $75.3 million or 88.0% of sales for the three months ended March 31, 2011 compared to $38.7 million or 76.9% in the prior year comparative period. In the fourth quarter of 2010, cost of products sold were $71.4 million or 85.5% of sales. The Fortress Specialty Cellulose mill was not yet acquired in the prior year comparative period.

Selling, general and administrative expenses were $9.3 million for the first quarter of 2011 (first quarter 2010, $6.5 million and fourth quarter 2010, $13.4 million). The Fortress Specialty Cellulose mill was not yet acquired in the prior year comparative period. Included in selling, general and administrative expenses in the fourth quarter of 2010 was the Executive Cash Award of $5 million.

Stock-based compensation expense was $0.5 million during the period ($0.3 million and $6.0 million in the first quarter of 2010 and the fourth quarter of 2010, respectively). Included in stock-based compensation in the fourth quarter of 2010 was a $5.6 million Executive Share Based Award.

In January of 2011 the Company completed the purchase of optical security assets which produces security material for the security threads used in banknotes. The assets were purchased through a wholly-owned subsidiary, Fortress Optical Features Ltd. ("Fortress Optical Features" or "FOF") for $0.75 million. The assets are being relocated to a high security production and research facility which the Company is building adjacent to its Fortress Specialty Cellulose mill in Quebec.

The recognition of assets acquired and liabilities assumed is based upon estimated fair values at the date of acquisition. Fair values are estimated using market information where applicable; however, directly comparable information is not always readily available so significant estimates and judgment are used. The Company believes it has made reasonable assumptions with respect to determining the fair values recognized.

The acquisition has been accounted for as follows:

Assets acquired at fair values:	
Inventory	$ 126
Property, plant and equipment	624
	750
Liabilities assumed at fair values	$ –
Net assets acquired at fair values	750
Consideration paid	750

Selected Financial Information and Statistics

(thousands of dollars, except per unit amounts and shipments, unaudited)	**Q1 2011**	**Q4 2010**	**Q1 2010**
Sales	85,488	83,467	50,304
EBITDA[1]	951	3,647	5,105
Operating (loss) income	(3,100)	(10,399)	3,430
Net (loss) income	(5,727)	(12,790)	(397)
Adjusted net (loss) income	(5,605)	(929)	2,252
Paper Shipments (tonnes)	15,468	15,406	16,386
Pulp Shipments (tonnes)	56,361	62,038	-

[1]See net income to EBITDA reconciliation.

During the fourth quarter of 2010, as part of the Chief Executive Officer's new six year contract, the Company approved a special bonus payment comprised of $5 million cash and $10 million in additional long term incentive awards based on performance milestones and vesting periods. Of this amount $10.6 million ("Executive Award") was expensed in the fourth quarter of 2010, consisting of $5 million cash ("Executive Cash Award") recorded in selling, general, and administrative and a further $5.6 million ("Executive Share Based Award") recognized in stock based compensation.

Net income to EBITDA reconciliation:

(thousands of dollars, unaudited)	Q1 2011	Q4 2010	Q1 2010
Net income	$(5,727)	$(12,790)	$(397)
Income tax	1,536	1,623	1,520
Foreign exchange (gain) loss	122	513	2,073
Net Interest expense (income)	969	255	234
Amortization	3,508	3,062	1,372
Stock based compensation	543	5,984	303
Executive cash award	-	5,000	-
EBITDA	$951	$3,647	$5,105

Operating Results by Business Segment

Pulp

(thousands of dollars, except for shipments, unaudited)	Q1 2011	Q4 2010
Sales	35,586	35,006
Operating loss	(940)	(283)
Shipments (tonnes)	56,361	62,038

During the first quarter of 2011 and fourth quarter of 2010, the Fortress Specialty Cellulose mill experienced NBHK pulp prices well off their highs experienced in 2010 and a strong Canadian dollar. The production of specialty pulp has resulted in a yield reduction and a higher realized price per tonne. In addition costs per tonne have been impacted by higher energy costs during the winter months and higher chemical costs as the mill begins transition preparation. The shut-down of the mill for conversion to dissolving pulp is scheduled for late third quarter 2011.

Security and Specialty Papers Segment

(thousands of dollars, except for shipments, unaudited)	Q1 2011	Q4 2010	Q1 2010
Sales	12,901	16,489	19,112
Operating (loss) income	(6,643)	(4,301)	163
Shipments (tonnes)	933	3,286	4,287

The Landqart mill completed the conversion of its PM1 from a specialty paper- machine into an efficient bank note paper-machine. Effective October 31, 2010 the last of the specialty papers were produced. Shipments in the first quarter of 2011 and fourth quarter of 2010 consisted of primarily low margin specialty and security papers. Towards the end of December the full conversion was substantially complete with production of saleable security paper on the rebuilt PM1.

The specialty papers sales have been largely influenced by non-woven simplex wallpaper base sales which have also been impacted by the significant increase in pulp prices relative to the prior year. Included in shipments for Q1 2011 are 514 tonnes of simplex wallpaper base from inventory compared to 1,644 tonnes and 1,581 tonnes in Q4 2010 and Q1 2010 respectively. Operating income was further negatively impacted by higher cotton and linter prices. As previously indicated Landqart is taking measures to improve efficiencies as the mill transitions to a higher capacity bank note and other security paper producer.

Fortress Optical Features began operations in the first quarter of 2011 generating sales of $0.9 million and contributing slightly to operating earnings.

Wallpaper Base Papers Segment

(thousands of dollars, except for shipments, unaudited)	Q1 2011	Q4 2010	Q1 2010
Sales	37,001	31,972	31,192
Operating income	7,006	6,527	5,705
Shipments (tonnes)	13,981	12,120	12,099

Tonnes shipped were approximately 15% higher relative to the prior comparative periods due to the capital programs increasing capacity and a decrease in finished inventory on hand at year end. Margins improved relative to the prior year comparative quarter and remained stable compared to the fourth quarter of 2010. This is a result of lower costs associated with decreased NBHK pulp prices and higher sales prices realized in the current and previous quarters relative to the first quarter of 2010. The order book at the Dresden mill remains strong.

Liquidity and Capital Resources

The Company's objectives when managing capital are to safeguard its assets and maintain a globally competitive cost structure while looking for growth opportunities to provide returns to its shareholders. In addition, the Company works with all relevant stakeholders to ensure the safety of its operations and employees, and remain in compliance with all environmental regulations and enhance the communities in which it operates.

The Company constantly monitors and assesses its financial performance in order to ensure that its net debt levels are prudent, taking into account the anticipated direction of the Company and business cycle. The company continuously monitors the public and private debt markets and the public equity markets in order to assure that its capital structure is appropriately balanced. The Company's results can be materially influenced by changes in the relative value of the Swiss Franc, Euro and US dollar to the Canadian dollar.

Although there can be no assurances, Fortress believes that cash generated from operations, together with amounts available under its credit facilities and net proceeds from equity financing will be sufficient to meet its debt service requirements, capital expenditure needs and working capital needs for the foreseeable future. Fortress' future operating performance and its ability to service its debt and pay other indebtedness of Fortress will be subject to future economic conditions and the financial success of Fortress' business and other factors, many of which are not within Fortress' control, including changes in market prices for its security and specialty papers and raw material costs.

As at March 31, 2011 and the date of this report, approximately $27 million and $44 million, respectively, of the originally planned project capital expenditure of $153 million has been spent for the conversion of Fortress Specialty Cellulose mill from an NBHK producer to a high quality specialty cellulose mill and to construct a new co-generation facility. The Company has reviewed and evaluated capital expenditure to be incurred in year 2012 relating to the construction of the co-generation facility using new equipment instead of refurbished equipment as previously budgeted and which will result in increased costs in the range of $20 million to $25 million. Project financing of $102.4 million from Investissement Quebec, current cash, federal credits, cash from operations, and the public offering in February 2011are expected to provide sufficient resources for completion.

At March 31, 2011, the Company had cash of $75.4 million and debt of $58.0 million. Included in this debt is $9.2 million drawn of the approximately $102.4 million facility with Investissement Quebec previously referenced.

Operating Activities

Selected Cash Flow Items

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Cash provided before working capital changes	(1,089)	3,946
Non-cash working capital change	(4,181)	(5,854)
Cash provided from (used by) operating activities	(5,270)	(1,908)
Net proceeds on common share issuance including option exercises	54,782	-
Net proceeds from debt	12,690	6,054
Cash provided from financing activities	67,472	6,054
Cash provided (used by) investing activities	(29,248)	(10,138)
Change in cash position	32,954	(5,992)
Foreign exchange (loss) gain on cash and cash equivalents	(85)	(2,400)

Fortress operates in a cyclical industry and its operating cash flows vary accordingly. Fortress' principal operating cash expenditures are for compensation, fibre, chemicals and debt service. Operating activities used cash of $5.3 million in the first quarter of 2011 compared to $1.9 in the first quarter of 2010.

Working capital is subject to cyclical operating needs, the timing of collection of receivables and the payment of payables and expenses.

Financing Activities

In February, 2011 Fortress completed a public offering by way of short form prospectus (“2011 Prospectus”) of 967,000, common shares of the Company and the underwriters exercised their over-allotment option and purchased an additional 145,050 common shares at a price of $51.75 per share, resulting in aggregate gross proceeds under the offering of $57.5 million. Proceeds of the offering are being used to finance certain capital expenditures relating to its Fortress Specialty Cellulose Mill in Thurso, Quebec and the construction of a high security facility adjacent to the Fortress Specialty Cellulose Mill which will house the Company's optical security material equipment recently acquired from the Bank of Canada, and for working capital and general corporate purposes.

In the 2011 Prospectus, the Company disclosed the following intended use of proceeds: (i) to finance certain capital expenditures relating to the Fortress Specialty Cellulose Mill (approximately $20 million); (ii) to finance certain capital expenditures relating to the Fortress Optical Facility and related expenditures (approximately $5 million); and (iii) the balance for working capital. Aggregate net proceeds received were $54.8 million.

Also in the quarter, Fortress’ wholly-owned subsidiary Dresden Papier GmbH ("Dresden") increased the current credit facility amounting to EUR18.5 million to EUR 22.15 million for the rebuild of Landqart’s PM1 into a banknote paper-machine. This facility was fully utilized at the end of the first quarter of 2011.

In the first quarter of 2011, the remaining $7 million principal amount of the Company's $15 million unsecured convertible debenture, that was issued on April 30, 2010, has been converted. The Company has issued 350,000 common shares with this redemption.

In the first quarter of 2010, financing activities generated $6.1 million related to loan proceeds of $6.8 million partially offset by $0.1 million repayment of capital lease, $0.3 million loan repayment and $0.3 finance expenses paid.

Investing Activities

Investing activities in the first quarters of 2011 and 2010 used cash of $29.2 million and $10.1 million, respectively. Investment activities relate primarily to the purchase of plant and equipment at the mills.

Outstanding Shares

The number of common shares outstanding at March 31, 2011 and the date of this report was 14,225,231 and 14,238,331, respectively. The number of options outstanding at March 31, 2011 and the date of this report was 592,550 and 579,450, respectively. At March 31, 2011 and the date of this report there were 315,202 restricted share units. At March 31, 2011 and the date of this report there were 140,976 and 141,580 deferred share units outstanding, respectively.

Critical Accounting Estimates

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates are used for, but not limited to, the accounting for doubtful accounts, depreciation and amortization, asset impairments, valuation of equity investment, derivative financial instruments, allocation of purchase price of acquisitions, stock based compensation, pensions and post-retirement obligations, income taxes and contingencies. Actual results could differ from these estimates.

Changes in Accounting Policies

Transition to and Initial Adoption of International Financial Reporting Standards

The company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the company has commenced reporting on this basis in the condensed interim consolidated financial statements as at March 31, 2011. For additional information on the conversion to IFRS, see the 2010 annual MD&A and the unaudited interim condensed consolidated financial statements, for the first quarter of 2011, accompanying this MD&A.

Impact of Adopting IFRS on the Company's Business

The adoption of IFRS has resulted in some changes to the Company's accounting systems and business processes. However, the impact has been minimal. The Company has not identified any contractual arrangements that are significantly impacted by the adoption of IFRS. The Company's staff involved in the preparation of financial statements has been appropriately trained on the relevant aspects of IFRS and the changes to accounting policies. The Company's Audit Committee has been regularly updated throughout the IFRS transition process, and is aware of the key aspects of IFRS as they impact the Fortress.

First-time Adoption of IFRS

The adoption of IFRS requires the application of IFRS 1, which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires retrospective application of IFRS effective at the end of its first annual IFRS reporting period. However, IFRS 1 also provides certain optional exemption and mandatory exceptions to this retrospective treatment.

Fortress has elected to apply the following optional exemptions in its preparation of an opening IFRS balance sheet as at January 1, 2010, the Company's transition date:

- Employee Benefits

IFRS 1 provides an option to recognize immediately in equity all cumulative actuarial gains and losses existing as at the date of transition to IFRS. The Company has elected this option.

- Property, Plant and Equipment

IFRS 1 permits a Company to revalue individual items of property, plant and equipment at their fair value as at the date of transition to IFRS. The Company elected to revalue the land at both Landqart and Dresden. This resulted in an increase to PP&E by $16.8 million as at January 1, 2010.

- Business Combinations

IFRS 1 provides an exemption that allows Companies transitioning to IFRS to not restate business combinations entered into prior to the date of transition. The Company elected to apply this exemption. The Company chose to early adopt Canadian Handbook Section 1582, "Business Combinations" effective April 1, 2010. This section is converged with IFRS 3, "Business Combination". The Thurso acquisition on April 30, 2010 had the same valuation under Canadian GAAP and IFRS.

- Cumulative Translation

In accordance with IFRS transitional provisions, the Company has elected to reset the cumulative translation adjustment account, which includes gains and losses arising from the translation of foreign operations, to zero at the date of transition to IFRS. Under Canadian GAAP the cumulative translation adjustment was also zero based on foreign subsidiaries being treated as integrated operations. As such, no adjustment is necessary to retroactively restate the cumulative translation adjustment account as at the date of transition to IFRS.

IFRS 1 does not permit changes to estimates that have been made previously. Accordingly, estimates used in the preparation of the Company's opening IFRS statement of financial position at the transition date are consistent with those made under previous Canadian GAAP.

Impact of Adopting IFRS on the Company's Accounting Policies

- Employee Benefits

IAS 19, "Employee Benefits", permits a Company to recognize actuarial gains and losses immediately in other comprehensive income rather than amortized through earnings.

IFRIC 14, "IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction", provides guidance on the size of an employee future benefit asset a company can recognize. Based on this guidance the employee future benefit recognized on the balance sheet of the Company will be $0.8 million as at January 1, 2010, $2.7 million as at March 31, 2010 and $1.8 million as at December 31, 2010.

- Share Based Payments

IFRS 2, "Share-based Payment", governs the treatment for share based compensation. Under IFRS 2, when share based payment awards vest in installments over the vesting period (graded vesting), each installment is accounted for as a separate arrangement. This treatment is permitted under Canadian GAAP but was not used by the Company. The Company's policy was to recognize stock based compensation straight line over the vesting period. This change was not material to the Company.

- Foreign Exchange Rates

IAS 21, "The Effects of Changes in Foreign Exchange Rates", requires that foreign denominated assets and liabilities are translated using the rates in effect at the balance sheet date. This will have an effect on any non-monetary items on the balance sheet translated using historical rates under Canadian GAAP. Using IAS 21, income and expense items for foreign operations are translated using the exchange rates in effect on the dates of the transactions or an average rate if it is considered a reasonable approximation.

Other comprehensive income was decreased by $3.7 million for the three months ended March 31, 2010 and increased by $1.9 million for the year ended December 31, 2010 to record a cumulative translation adjustment.

- Provisions

IAS 37, "Provisions, Contingent Liabilities and Contingent Assets", requires a provision to be recognized when there is a present obligation as a result of a past transaction or event; it is probable that an outflow of resources will be required to settle the obligation; and a reliable estimate can be made of the obligation. The threshold of "probable" is a lower threshold than "likely", which is used in Canadian GAAP. Therefore, it is possible that there may be some contingent liabilities which would meet the recognition criteria under IFRS that were not recognized under Canadian GAAP. Other differences between IFRS and Canadian GAAP exist in relation to the measurement of provisions, such as the methodology for determining the best estimate where there is a range of equally possible outcomes (IFRS uses the mid-point of the range, whereas Canadian GAAP uses the low-end of the range), and the requirement under IFRS for provisions to be discounted where material.

- Acquisition Costs

Under IFRS, all acquisition related costs of the acquirer in a business combination must be accounted for as expenses in the period in which they were incurred. Under Canadian GAAP incremental costs that were directly attributable to the purchase were included in the purchase price. As a result of this change the Company has charged $0.5 million in deferred expenses previously recognized as an asset under Canadian GAAP directly to equity as at January 1, 2010. Net income was also reduced by $0.6 million for the three months ended March 31, 2010 and increased by $0.5 million for the year ended December 31, 2010 as a result of this change.

IFRS Transitional Impact on Equity

As a result of the policy choices selected and changes required under IFRS, Fortress has recorded an increase in equity of $8.2 million as at the date of transition, January 1, 2010. The table below outlines adjustments to equity on adoption of IFRS on January 1, 2010, and at March 31, 2010 and December 31, 2010 for comparative purposes:

Equity	**December 31, 2010**	**March 31, 2010**	**January 1, 2010**
Equity as reported under Canadian GAAP	180,266	86,981	86,584
Property, plant and equipment revaluation	16,833	16,833	16,833
Foreign exchange on property, plant and equipment	3,321	(1,895)	2,176
Foreign exchange on inventory	(23)	(643)	(816)
Employee future benefits – actuarial gains and losses	(8,753)	(6,199)	(6,295)
Employee future benefits – asset limit	(43)	(669)	(2,784)
Deferred income tax	(1,572)	(1,415)	(1,199)
Deferred expenses	–	(1,053)	(476)
Long term debt revaluation	757	848	945
Equity as reported under IFRS	190,786	92,788	94,968

IFRS Impact on Comprehensive Income

The following is a summary of the adjustments to Comprehensive Income for the three months ended March 31, 2010 and the year ended December 31, 2010 under IFRS:

	Year ended December 31, 2010 $	**Three months ended March 31, 2010 $**
Comprehensive income		
As reported under Canadian GAAP	34,753	179
Increase (decrease) in net income for:		
Foreign exchange on translation of foreign operations	(613)	309
Stock based compensation	(227)	(84)
Employee future benefits	33	(128)
Deferred expenses	476	(577)
Deferred income tax	(143)	(58)
Redemption of convertible note	(246)	–
Interest expense	(222)	(54)
Depreciation and other	52	16
	33,863	(397)
Increase (decrease) in comprehensive income for:		
Cumulative translation adjustment	1,915	(3,688)
Employee future benefits – actuarial gains and losses	(1,582)	(53)
Employee future benefits – asset limit	2,224	1,655
	2,557	(2,086)
As reported under IFRS	36,420	(2,483)

IFRS Impact on Cash Flow Statement

The transition from Canadian GAAP to IFRS had no significant impact on cashflows generated by the Company.

Disclosure Controls and Internal Controls over Financial Reporting

During the quarter ending March 31, 2011, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

Risks and Uncertainties

A comprehensive discussion of Risk Factors is included in the Company's 2010 annual information form available on SEDAR at www.sedar.com.

Selected Quarterly Information

	International Financial Reporting Standards (IFRS)			
(thousands of dollars, except per unit amounts, earnings per share ("EPS"), exchange rates and shares outstanding, unaudited)	**Q1 2011**	**Q4 2010**	**Q3 2010**	**Q2 2010**
Sales	85,488	83,467	86,971	60,544
Operating (loss) income	(3,100)	(10,399)	5,931	2,376
EBITDA	951	3,647	8,800	9,016
Net income	(5,727)	(12,790)	5,233	41,815
Basic EPS	($0.43)	($1.01)	$0.43	$4.08
Diluted EPS	($0.43)	($1.01)	$0.38	$3.65
Weighted average shares outstanding Basic (thousands)	13,417	12,626	12,003	10,237
Weighted average shares outstanding Diluted (thousands)	13,417	12,626	13,482	11,450
Average Swiss/Canadian exchange rate(1)	1.0476	1.0397	1.0085	0.9278
Average Euro/Canadian exchange rate (1)	1.3497	1.3760	1.3438	1.3057

	IFRS	Previous Canadian GAAP		
(thousands of dollars, except per unit amounts, earnings per share ("EPS"), exchange rates and shares outstanding, unaudited)	**Q1 2010**	**Q4 2009**	**Q3 2009**	**Q2 2009**
Sales	50,304	51,049	51,000	49,638
Operating income	3,430	6,292	5,198	4,460
EBITDA	5,105	7,885	6,967	5,699
Net income	(397)	3,720	3,467	1,926
Basic EPS	($0.04)	$0.36	$0.34	$0.19
Diluted EPS	($0.04)	$0.35	$0.34	$0.19
Weighted average shares outstanding Basic (thousands)	10,234	10,234	10,234	10,234
Weighted average shares outstanding Diluted (thousands)	10,234	10,487	10,296	10,234
Average Swiss/Canadian exchange rate(1)	0.9832	1.0341	1.0335	1.0498
Average Euro/Canadian exchange rate (1)	1.4381	1.5600	1.5699	1.5891

(1) Source – Bank of Canada (average noon rate for the period)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Canadian dollars, amounts in thousands, unaudited)

	March 31, 2011 $	December 31, 2010 $	January 1, 2010 $
ASSETS			
Current			
Cash and cash equivalents	75,428	42,559	33,205
Trade accounts receivable	19,306	10,616	18,034
Other accounts receivable	7,752	16,099	2,614
Inventories	45,287	41,164	26,064
Prepaid expenses	2,636	1,755	873
	150,409	112,193	80,790
Restricted cash	3,481	1,362	45
Property, plant and equipment *(note 5)*	211,280	186,774	66,861
Employee future benefits *(note 5)*	3,014	1,768	809
Total assets	368,184	302,097	148,505
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities	38,251	38,878	22,447
Income taxes payable	4,130	3,503	4,446
Current portion of long-term debt *(note 8)*	9,245	8,977	5,378
	51,626	51,358	32,271
Long-term debt *(note 8)*	48,770	41,242	18,039
Deferred income taxes	18,248	18,526	3,227
Provisions	747	185	–
Total liabilities	119,391	111,311	53,537
Shareholders' equity			
Share capital *(note 9)*	174,593	111,148	59,083
Contributed surplus	9,332	10,536	3,198
Accumulated other comprehensive income	2,399	1,909	–
Retained earnings	62,469	67,193	32,687
Total shareholders' equity	248,793	190,786	94,968
Total liabilities and shareholders' equity	368,184	302,097	148,505

(See accompanying notes)

Approved by the Board of Directors:

"Chadwick Wasilenkoff" Director

"Richard Whittall" Director

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the three months ended
(Canadian dollars, amounts in thousands, unaudited)

	March 31, 2011 $	March 31, 2010 $
Sales	85,488	50,304
Costs and expenses		
Cost of products sold	(75,259)	(38,700)
Amortization	(3,508)	(1,372)
Selling, general and administration	(9,278)	(6,499)
Stock-based compensation	(543)	(303)
Operating (loss) income	(3,100)	3,430
Other income (expense)		
Finance expense	(1,089)	(253)
Finance income	120	19
Foreign exchange loss	(122)	(2,073)
Net (loss) income before income taxes	(4,191)	1,123
Income tax expense	(1,536)	(1,520)
Net loss for the period	(5,727)	(397)
Loss per share		
Basic and diluted	($0.43)	($ 0.04)
Weighted average number of shares outstanding		
Basic and diluted	13,417,069	10,233,500

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

For the three months ended
(Canadian dollars, amounts in thousands, unaudited)

	March 31, 2011 $	March 31, 2010 $
Net loss for the period	(5,727)	(397)
Other comprehensive income (loss)		
Cumulative translation adjustment	490	(3,688)
Actuarial gain (loss) recognized on employee future benefits (net of taxes of ($178) and $11)	1,065	(53)
Asset limit on employee future benefits (net of taxes of $10 and ($333))	(62)	1,655
Total other comprehensive income (loss) for the period	1,493	(2,086)
Total comprehensive income (loss) for the period	(4,234)	(2,483)

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Canadian dollars, amounts in thousands, unaudited)

	Share capital $	Contributed surplus $	Accumulated other comprehensive income (loss) $	Retained earnings $	Total equity $
Balance – December 31, 2010	111,148	10,536	1,909	67,193	190,786
Net loss for the period	–	–	–	(5,727)	(5,727)
Other comprehensive income (net of tax)	–	–	1,493	–	1,493
Comprehensive income (loss) for the period	–	–	1,493	(5,727)	(4,234)
Employee future benefit adjustments moved to retained earnings	–	–	(1,003)	1,003	–
Employee share options *(note 10)*:					
Stock based compensation	–	543	–	–	543
Restricted share units vested	615	(615)	–	–	–
Options exercised	685	(184)	–	–	501
Redemption of convertible note *(note 8)*	7,363	(948)	–	–	6,415
Private placement *(note 9)*	54,782	–	–	–	54,782
Balance – March 31, 2011	174,593	9,332	2,399	62,469	248,793
Balance – January 1, 2010	59,083	3,198	–	32,687	94,968
Net loss for the period	–	–	–	(397)	(397)
Other comprehensive loss (net of tax)	–	–	(2,086)	–	(2,086)
Comprehensive income (loss) for the period	–	–	(2,086)	(397)	(2,483)
Employee future benefit adjustments moved to retained earnings	–	–	(1,602)	1,602	–
Employee share options *(note 10)*:					
Stock based compensation	–	303	–	–	303
Balance – March 31, 2010	59,083	3,501	(3,688)	33,892	92,788

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the three months ended
(Canadian dollars, amounts in thousands, unaudited)

	March 31, 2011 $	March 31, 2010 $
Cash flows (used by) from operating activities		
Net loss	(5,727)	(397)
Items not affecting cash:		
Amortization	3,508	1,372
Deferred income taxes	(318)	51
Foreign exchange loss (gain)	122	2,246
Finance expense	783	372
Stock based compensation	543	302
	(1,089)	3,946
Change in non-cash working capital items		
Accounts receivable	190	(2,797)
Inventories	(3,503)	(2,773)
Prepaid expenses	(882)	280
Accounts payable and accrued liabilities	14	(564)
	(5,270)	(1,908)
Cash flows from (used by) financing activities		
Options exercised	501	–
Repayment of long-term debt	(262)	(279)
Proceeds from long-term debt	13,145	6,752
Net proceeds from issuance of common shares	54,782	–
Payment on capital leases	(54)	(101)
Payment of long-term debt interest	(640)	(318)
	67,472	6,054
Cash flows used by investing activities		
Additions to property, plant and equipment	(26,379)	(10,141)
Restricted cash	(2,119)	3
Acquisition of Fortress Optical Features (*note 7*)	(750)	–
	(29,248)	(10,138)
Increase (decrease) in cash position	32,954	(5,992)
Foreign exchange loss on cash and cash equivalents	(85)	(2,400)
Cash and cash equivalents, beginning of year	42,559	33,205
Cash and cash equivalents, end of year	75,428	24,813

Supplementary cash flow information *(note 13)*

(See accompanying notes)

1. NATURE OF OPERATIONS

Fortress Paper Ltd. (the "Company" or "Fortress") was incorporated on May 30, 2006 under the laws of the Province of British Columbia. The address of the Company's registered office is 157 Chadwick Court – 2nd floor, North Vancouver, British Columbia, Canada V7M 3K2. From the date of incorporation to July 31, 2006, the Company was inactive. The Company's fiscal year-end is December 31. Fortress owns and operates two paper mills, the Landqart mill located in Switzerland and the Dresden mill located in Germany, and a pulp mill in Canada. Fortress' security papers include banknote, passport and visa papers. The security papers produced at the Landqart mill incorporate internationally recognized overt and covert security features which are embedded into the paper and supplemented with customer-specific features. The Landqart mill has leveraged its extensive security papers competence to develop additional commercial applications using its in-house know-how and technology of security features to create innovative paper-based security products. Fortress' specialty papers business includes non-woven wallpaper base products, as well as graphic and technical papers. The Dresden mill produces coated and uncoated wallpaper base for wallpaper manufacturers. The pulp mill, Fortress Specialty Cellulose, produces northern bleached hardwood kraft and is in the process of being converted into a dissolving pulp mill.

2. BASIS OF PRESENTATION AND ADOPTION OF IFRS

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the company has commenced reporting on this basis in these condensed interim consolidated financial statements. In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These condensed interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1. Subject to certain transition elections disclosed in note 4, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 4 discloses the impact of the transition to IFRS on the company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010.

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of June 8, 2011, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of these interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

The condensed interim consolidated financial statements should be read in conjunction with the company's Canadian GAAP annual financial statements for the year ended December 31, 2010. Note 5 discloses IFRS information for the year ended December 31, 2010 that is material to an understanding of these condensed consolidated interim financial statements.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements include the accounts of the Company and, from their respective dates of acquisition of control or formation, its wholly owned subsidiaries.

All significant intercompany transactions and balances have been eliminated.

Foreign Currency Translation

(i) Functional and presentation currency

Items included in the financial statements of each consolidated entity are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

The financial statements of entities that have a functional currency other than Canadian ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities – at the closing rate at the date of the statement of financial position, and income and expenses – using actual rates in place at the time or an average rate if it is considered a reasonable approximation. All resulting changes are recognized in other comprehensive income as cumulative translation adjustments.

When an entity disposes of its entire interest in a foreign operation, or loses control, joint control, or significant influence over a foreign operation, the foreign currency gains or losses accumulated in other comprehensive income related to the foreign operation are recognized in profit or loss. If an entity disposes of part of an interest in a foreign operation which remains a subsidiary, a proportionate amount of foreign currency gains or losses accumulated in other comprehensive income related to the subsidiary are reallocated between controlling and non-controlling interests.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in currencies other than an operation's functional currency are recognized in the statement of income.

Cash and Cash Equivalents

The Company considers cash, cash in banks, and deposits with financial institutions with original maturities of three months or less and that can be liquidated without prior notice or penalty, to be cash or cash equivalents.

Financial Instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount reported in the Statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

(i) Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges. The Company does not hold any instruments in this category.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statement of operations. Gains and losses arising from changes in fair value are presented in the statement of operations within other gains and losses in the period in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the balance sheet date, which is classified as non-current.

(ii) Available-for-sale investments: Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company does not hold any instruments in this category.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive income. Available-for-sale investments are classified as non-current, unless the investment matures within twelve months, or management expects to dispose of them within twelve months.

Interest on available-for-sale investments, calculated using the effective interest method, is recognized in the statement of operations as part of interest income. Dividends on available-for-sale equity instruments are recognized in the statement of operations as part of other gains and losses when the company's right to receive payment is established. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of income and included in other gains and losses.

(iii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The company's loans and receivables are comprised of trade receivables, other receivables, restricted cash and cash and cash equivalents. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

The company transfers trade receivables under certain financial institution sponsored revolving securitization programs. Because the company transfers substantially all the risks and rewards of ownership of the factored receivables, it derecognizes the carrying amount of these receivables as the cash is received.

(iv) Financial liabilities at amortized cost: Financial liabilities at amortized cost include trade payables and long-term debt. Trade payables are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method. Bank debt and long-term debt are recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

(v) Derivative financial instruments: The Company does not hold any derivative financial instruments.

Inventories

Inventories are valued at the lower of average cost and net realizable value. The cost of finished goods and work-in-progress comprises raw materials, direct labour, other direct costs and related production overheads including applicable depreciation on property, plant and equipment. Net realizable value is the estimated selling price.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated amortization.

No amortization is charged on major improvements or expansions until the asset is ready for intended use. Betterments and replacements, including leasehold and other improvements that extend the assets' useful life or productive capabilities of major units of property and equipment are capitalized. Maintenance, repairs and minor replacements are expensed as incurred. The carrying amount of a replaced asset is derecognized when replaced.

Property, plant and equipment are principally amortized on a straight-line basis over their estimated useful lives as follows:

Buildings	10-50 years
Manufacturing equipment and machinery	5-20 years
Fixtures and other equipment	3-10 years

The Company allocates the amount initially recognized in respect of an item of property plant, and equipment to its significant parts and depreciates separately each such part. Residual values, methods of amortization and useful lives are reviewed and adjusted if appropriate.

Impairment of long-lived assets

The Company reviews property, plant, and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or cash generating unit). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

Borrowing costs

Borrowing costs attributable to the acquisition, construction or production of qualifying assets are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognized as interest expense in the statement of operations in the period in which they are incurred.

Employee future benefits

Employees of companies included in these consolidated financial statements have entitlements under company pension plans which are either defined contribution or defined benefit pension plans. These plans take different forms depending on the legal regime of each country.

For the Company's defined contribution pension plan, contributions are recognized as employee benefit expense when they are due.

For the Company's defined benefit pension plan the following policies have been adopted:

- The measurement date used for accounting purposes is December 31;
- The cost of pensions earned by employees is actuarially determined using the projected unit credit method pro-rated on service and management's estimate of expected plan investment performance, salary escalation and retirement ages of employees;
- The discount rate applied in arriving at the present value of the pension liability represents yields on high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the pension liability;
- For the purpose of calculating the expected return on plan assets, those assets are valued at fair value;
- The related pension asset recognized in the statement of financial position is the fair value of the plan assets less the present value of the defined benefit obligation at the balance sheet date;
- Actuarial gains and losses are recognized in full in the period in which they occur, in other comprehensive income and retained earnings without recycling to the statement of income in subsequent periods.

Income taxes

Income taxes are comprised of current and deferred taxes. Income tax is recognized in the statement of operations except to the extent that it relates to items recognized directly in equity, in which case the income tax is recognized directly in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted, or substantively enacted, at the end of the reporting period, and any adjustments to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined on a non-discounted basis using tax rates and laws that that have been enacted or substantively enacted at the balance sheet date and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered.

Deferred income tax is provided for taxable temporary differences associated with investments in subsidiaries except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

Deferred income tax assets and liabilities are presented as non-current.

Taxes on income in interim periods are accrued using the tax rate that would be applicable to expected total annual earnings.

Earnings (loss) per share

Basic earnings (loss) per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share amounts are calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares using the treasury stock method. The treasury stock method assumes that proceeds received from the exercise of stock options and warrants are used to repurchase common shares at the prevailing market rate.

Stock-based compensation

The Company grants stock options and other share based awards to certain employees. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. Fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. The value of stock options granted to directors and officers is recorded as stock-based compensation and credited to contributed surplus over the relevant vesting period. Any consideration received on the exercise of stock options is credited to share capital and the appropriate original fair value is reallocated from contributed surplus to share capital.

Performance options and share awards based on certain conditions are recognized when it is considered likely that the performance condition will be achieved.

Revenue and related cost recognition

The Company recognizes revenue from product sales when persuasive evidence of an arrangement exists, the sales price is fixed or determinable, title of ownership and risk of loss have passed to the customer and collectability is reasonably assured. Sales are reported net of discounts and allowances. Amounts charged to customers for shipping and handling are recognized as revenue. The Company does not have any multiple element revenue arrangements. Shipping and handling costs incurred by the Company are included in cost of products sold.

Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in Canada requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates are used for, but not limited to, the accounting for doubtful accounts, amortization, asset recoverability, derivative financial instruments, fair valuation of acquired assets, employee future benefits, provisions, stock compensation, income taxes and contingencies. Actual results could differ from these estimates.

Provisions

Provisions for cleanup of landfill sites and legal claims, where applicable, are recognized as liabilities when the Company has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted to present value where the effect is material.

4. TRANSITION TO IFRS

The effect of the Company's transition to IFRS, as described in Note 2, is summarized in this note as follows:

(i) Transition elections

The Company has applied the following transition exemptions to full retrospective application of IFRS:

	As described in Note 4 (ii)
Deemed cost of property, plant and equipment	a
Employee benefits – treatment of actuarial gains and losses	b
Cumulative translation adjustment	c
Business combinations	d
Borrowing costs	e

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

(ii) Reconciliation of equity and comprehensive income as previously reported under Canadian GAAP to IFRS

	Ref	December 31, 2010 $	March 31, 2010 $	January 1, 2010 $
Equity				
Equity as reported under Canadian GAAP		180,266	86,981	86,584
IFRS adjustments increase (decrease):				
Foreign exchange on property, plant and equipment	a	3,321	(1,895)	2,176
Foreign exchange on inventory	a	(23)	(643)	(816)
Employee future benefits – actuarial gains and losses	b	(8,753)	(6,199)	(6,295)
Property, plant and equipment revaluation	f	16,833	16,833	16,833
Employee future benefits – asset limit	g	(43)	(669)	(2,784)
Deferred income tax	h	(1,572)	(1,415)	(1,199)
Deferred expenses	i	–	(1,053)	(476)
Long term debt revaluation	j	757	848	945
Equity as reported under IFRS		190,786	92,788	94,968

	Ref	Year ended December 31, 2010 $	Three months ended March 31, 2010 $
Comprehensive income			
As reported under Canadian GAAP		34,753	179
Increase (decrease) in net income for:			
Deferred income tax	h	(143)	(58)
Deferred expenses	i	476	(577)
Interest expense	j	(222)	(54)
Foreign exchange on translation of foreign operations	k	(613)	309
Depreciation and other	k	52	16
Stock based compensation	l	(227)	(84)
Redemption of convertible note	m	(246)	–
Employee future benefits	n	33	(128)
		33,863	(397)
Increase (decrease) in comprehensive income for:			
Cumulative translation adjustment	k	1,915	(3,688)
Employee future benefits – actuarial gains and losses	b	(1,582)	(53)
Employee future benefits – asset limit	g	2,224	1,655
		2,557	(2,086)
As reported under IFRS		36,420	(2,483)

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

(a) Under IFRS, non-monetary balance sheet items denominated in a foreign currency are translated into the presentation currency of the Company using the exchange rate in place at the balance sheet date for foreign subsidiaries being consolidated. Under Canadian GAAP non-monetary balance sheet items for integrated subsidiaries were translated using historical rates. Property, plant and equipment and inventory in Germany and Switzerland have been revalued for IFRS using the exchange rates in place as at the balance sheet date.

(b) Under IFRS, the Company recognizes actuarial gains and losses arising from the re-measurement of employee future benefit obligations in other comprehensive income as they arise. Under Canadian GAAP, the company applied the corridor method of accounting for such gains and losses. Under this method, gains and losses are recognized only if they exceed specified thresholds. The carrying value of the net asset for employee future benefits was reduced by $6,295 as at January 1, 2010 to recognize previously unamortized accumulated actuarial gains and losses. Actuarial losses of $64 previously unrecognized under Canadian GAAP were recognized for the three months ended March 31, 2010 for IFRS. Actuarial losses of $1,900 previously unrecognized under Canadian GAAP were recognized for the year ended December 2010 for IFRS.

(c) In accordance with IFRS transitional provisions, the Company has elected to reset the cumulative translation adjustment account, which includes gains and losses arising from the translation of foreign operations, to zero at the date of transition to IFRS. Under Canadian GAAP the cumulative translation adjustment was also zero based on foreign subsidiaries being treated as integrated operations. As such, no adjustment is necessary to retroactively restate the cumulative translation adjustment account as at the date of transition to IFRS.

(d) In accordance with IFRS transitional provisions, the Company elected to apply IFRS relating to business combinations prospectively from January 1, 2010. As such, Canadian GAAP balances relating to business combinations entered into before that date have been carried forward without adjustment.

(e) In accordance with IFRS transitional provisions, the Company has elected to apply IFRS relating to borrowing costs prospectively from January 1, 2010. As such, Canadian GAAP balances relating to long term debt arrangements entered into for the construction of property, plant and equipment before that date have been carried forward without adjustment.

(f) In accordance with IFRS transitional provisions, the Company elected to revalue land in Germany and Switzerland by $16,833 to its fair value as at January 1, 2010. There has been no corresponding change to income or accumulated amortization.

(g) Under IFRS, IFRIC 14 provides specific guidance on the calculation of the amount of an employee future benefit asset a company can recognize. Based on this guidance the employee future benefit recognized on the balance sheet of the Company will be $0.8 million as at January 1, 2010, $2.7 million as at March 31, 2010 and $1.8 million as at December 31, 2010.

(h) Deferred income tax liabilities have been adjusted to give effect to adjustments as follows:

	Ref	December 31, 2010 $	March 31, 2010 $	January 1, 2010 $
Property, plant and equipment revaluation	a	$ 3,273	$ 2,726	$ 2,932
Employee future benefits – actuarial gains and losses	b	(1,588)	(1,136)	(1,201)
Employee future benefits – asset limit	g	(113)	(175)	(532)
		$ 1,572	$ 1,415	$ 1,199

Under IFRS, deferred income tax amounts related to actuarial gains and losses on employee future benefits and the limit on the asset for employee future benefits are recognized by the Company in other comprehensive income. Under Canadian GAAP, deferred income tax amounts related to employee future benefits were recorded in net income.

(i) Under IFRS, all acquisition related costs of the acquirer in a business combination must be accounted for as expenses in the period in which they were incurred. Under Canadian GAAP incremental costs that were directly attributable to the purchase were included in the purchase price. As a result of this change the Company has charged $476 in deferred expenses previously recognized as an asset under Canadian GAAP directly to equity as at January 1, 2010. Net income was also reduced by $577 for the three months ended March 31, 2010 and increased by $476 for the year ended December 31, 2010 as a result of this change.

(j) Upon conversion to IFRS a non-interest bearing loan with a principal amount of $5,366 was valued at amortized cost of $4,440 using an imputed interest rate of 5%. This resulted in a decrease in long term debt and an increase in retained earnings of $945 as at January 1, 2010. The imputed interest expense was $54 for the three months ended March 31, 2010 and $222 for the year ended December 31, 2010.

(k) Under IFRS, The financial statements of entities that have a functional currency other than Canadian ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities – at the closing rate at the date of the statement of financial position, and income and expenses – using actual rates in place at the time or an average rate if it is considered a reasonable approximation. All resulting changes are recognized in other comprehensive income as cumulative translation adjustments.

Under Canadian GAAP, monetary assets and liabilities are translated at the closing rate at the date of the statement of financial position with translation adjustments being recognized in income. Non-monetary assets and liabilities are translated using historical foreign exchange rates. Depreciation related to property, plant and equipment was translated at historical foreign exchange rates. All other income and expense items were translated using average exchange rates for the period.

As such, depreciation expense and property, plant and equipment were decreased by $16 for the three months ended March 31, 2010 and decreased by $52 for the year ended December 31, 2010.

Other comprehensive income was decreased by $3,688 for the three months ended March 31, 2010 and increased by $1,915 for the year ended December 31, 2010 to record a cumulative translation adjustment.

(l) Under IFRS, when share based payment awards vest in installments over the vesting period (graded vesting), each installment is accounted for as a separate arrangement. This treatment is allowed under Canadian GAAP but was not used by the Company. The Company's former policy under Canadian GAAP was to recognize stock based compensation straight line over the vesting period. This change in treatment has resulted in an increase to contributed surplus and a decrease in retained earnings of $110 for share based awards that were issued to officers of the Company but had not fully vested as at January 1, 2010. For the three months ended March 31, 2010 the Company recorded an increase in contributed surplus and an increase in stock based compensation of $84. For the year ended December 31, 2010, the Company recorded an increase in contributed surplus and an increase in stock based compensation of $227.

(m) Under IFRS, the conversion of the convertible note is treated as an increase in share capital with no gain or loss recorded. Under Canadian GAAP, the liability and equity components were re-valued at the time of conversion with a gain or loss recognized in income and an adjustment made to retained earnings. As such, during the year ended December 31, 2010 retained earnings was increased by $166 and income was decreased by $246 as a result of the partial conversion of a convertible note on October 1, 2010. Share capital was increased by $80 for the year ended December 31, 2010.

(n) Under IFRS, the Company has chosen an accounting policy for employee future benefits that recognizes all actuarial gains and losses in other comprehensive income in the period in which they occur. Under Canadian GAAP, the Company amortized these gains and losses to income using the corridor method.

(iii) Adjustments to the statements of cashflows

The transition from Canadian GAAP to IFRS had no significant impact on cashflows generated by the Company. The IFRS transition adjustments did not have an impact on cash and cash equivalents.

5. ADDITIONAL IFRS INFORMATION FOR THE YEAR ENDED DECEMBER 31, 2010

The following IFRS disclosures relating to the year ended December 31, 2010 are material to an understanding of these interim financial statements.

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

(i) Property, plant and equipment

	2010				
	Land	**Building**	**Plant and Equipment**	**Work in Progress**	**Total**
	$	**$**	**$**	**$**	**$**
Net book value					
At January 1, 2010:					
Cost	21,286	6,619	48,944	1,931	78,780
Accumulated depreciation	–	(657)	(11,262)	–	(11,919)
	21,286	5,962	37,682	1,931	66,861
At January 1, 2010	21,286	5,962	37,682	1,931	66,861
Purchase of Thurso mill *(note 6)*	1,196	28,408	29,312	–	58,916
Additions	–	333	3,927	61,717	65,977
Disposals	–	(23)	(1,595)	–	(1,618)
Transfers	–	52	1,347	(1,399)	–
Depreciation for the year	–	(1,090)	(7,495)	–	(8,585)
Exchange differences	314	320	885	3,704	5,224
At December 31, 2010	22,796	33,962	64,063	65,953	186,774
At December 31, 2010:					
Cost	22,796	35,745	81,294	65,953	205,788
Accumulated depreciation	–	(1,783)	(17,231)	–	(19,014)
	22,796	33,962	64,063	65,953	186,774

(ii) Employee future benefits

The Company maintains a defined benefit pension plan in Switzerland providing pension benefits based on either length of service or earnings and length of service. The Company measures its accrued benefit obligations and fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation for the plan was December 31, 2010.

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

The status of the Company's defined benefit pension plans is as follows:

	Year Ended December 31, 2010 $
Accrued benefit obligation	
Beginning of year	56,905
Service cost	1,491
Interest cost on accrued obligation	1,798
Benefit payments	(3,357)
Contributions by plan participants	1,114
Actuarial loss and other	1,297
Foreign exchange	3,206
End of year	62,454
Plan assets	
Fair value, beginning of year	60,499
Actual return on plan assets	1,598
Employer contributions	1,114
Employee contributions	1,114
Benefit payments	(3,356)
Foreign exchange	3,253
End of year	64,222
Funded status — plan surplus	1,768

	Year Ended December 31, 2010 $
Pension expense recognized in net income	
Current service cost	1,604
Interest cost	1,935
Expected return on plan assets	(2,524)
Net expense recognized in net income	1,015

	Year Ended December 31, 2010 $
Amount recognized in other comprehensive income	
Actuarial loss on plan assets in current period	806
Actuarial loss on benefit obligation in current period	1,395
Effect of asset limit reversal	(2,933)
Gain recognized in other comprehensive income	(732)

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

	2010
Significant actuarial assumptions used are as follows	%
Discount rate to determine benefit obligations at end of year	2.9
Discount rate to determine benefit expense (income) for the year	2.9
Expected rate of return on plan assets	4.0
Rate of increase in future compensation	1.5
Plan assets at fair value at the end of the year	%
Liquid assets	6.0
Bonds	50.2
Equity — World	24.8
Real estate	19.0
	100.0

6. ACQUISITION OF THURSO PULP MILL

On April 30, 2010, the Company completed the purchase of a northern bleached hardwood kraft pulp mill located in Thurso, Quebec from Fraser Papers Inc. through a wholly-owned subsidiary, Fortress Specialty Cellulose Inc. (“Fortress Specialty Cellulose” or “FSC”), for $3 million. The Company is in the process of converting the Thurso operations into a dissolving pulp mill.

The recognition of assets acquired and liabilities assumed is based upon estimated fair values at the date of acquisition. Fair values are estimated using market information where applicable; however, directly comparable information is not always readily available so significant estimates and judgment are used. The Company believes it has made reasonable assumptions with respect to determining the fair values recognized.

A gain of $41,804 has been recognized as the estimated fair values of the net assets acquired exceed consideration paid. The gain has been included as other income in the statement of operations.

The acquisition has been accounted for as follows:

Assets acquired at fair values:	
Inventory	$ 6,019
Property, plant and equipment	58,915
	64,934
Liabilities assumed at fair values:	
Accounts payable	$ 3,652
Asset retirement obligations	562
Future income tax liabilities	15,916
	20,130
Net assets acquired at fair values	44,804
Consideration paid	3,000
Fair value gain on acquisition	$ 41,804

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

7. ACQUISITION OF FORTRESS OPTICAL FEATURES

In January of 2011 the Company completed the purchase of optical security assets which produces security material for the security threads used in banknotes. The assets were purchased through a wholly-owned subsidiary, Fortress Optical Features Ltd. ("Fortress Optical Features" or "FOF") for $750. The assets will be relocated to a high security production and research facility that the Company will be building adjacent to its FSC mill in Quebec.

The recognition of assets acquired and liabilities assumed is based upon estimated fair values at the date of acquisition. Fair values are estimated using market information where applicable; however, directly comparable information is not always readily available so significant estimates and judgment are used. The Company believes it has made reasonable assumptions with respect to determining the fair values recognized.

The acquisition has been accounted for as follows:

Assets acquired at fair values:	
Inventory	$ 126
Property, plant and equipment	624
	750
Liabilities assumed at fair values	$ –
Net assets acquired at fair values	750
Consideration paid	$ 750

8. LONG-TERM DEBT

Long-term debt

	March 31, 2011 $	December 31, 2010 $	January 1, 2010 $
Credit agreement with bank maturing 2014; interest at 2.65% secured by current assets (EUR 2,281; Dec 2010 : EUR 2,431; Jan 2010 : EUR 3,223)	3,143	3,238	4,835
Credit agreement with lender maturing 2018; interest at 6.2% and 7.1% secured by fixed assets (EUR 21,837; Dec 2010 : EUR 15,377; Jan 2010 : EUR 0) (a)	30,096	20,481	–
Credit agreement with bank maturing 2012; interest at 4.8% unsecured (CHF 3,140; Dec 2010 : CHF 3,140; Jan 2010 : CHF 4,710)	3,332	3,344	4,760
Credit agreement with bank maturing 2011, 2013 and 2018; interest up to 3.1% and 4.9% secured by fixed assets (CHF 7,560; Dec 2010 : CHF 7,560; Jan 2010 : CHF 8,820)	8,022	8,048	8,914
Credit agreement with lender maturing 2016; unsecured (CHF 4,657; Dec 2010: CHF 4,598; Jan 2010: CHF 4,375) (b)	4,942	4,895	4,422
Capital leases; interest at 4.0% (EUR 103; Dec 2010 : EUR 147; Jan 2010 : EUR 324)	142	196	486
Credit agreement with lender maturing 2015; interest at 7% unsecured (c)	–	6,248	–

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

Credit agreement with lender maturing 2014; interest up to 5.5% secured by assets (d)	8,338	3,769	–
	58,015	50,219	23,417
Less: Current portion	(9,245)	(8,977)	(5,378)
	$ 48,770	$ 41,242	$ 18,039

Borrowings under the above agreements require maintenance of certain financial and non-financial covenants. The Company has been in compliance with all covenants for the three months ended March 31, 2011.

(a) The credit agreement is a facility for up to EUR 22.2 million, of which EUR 22.2 million has been drawn as at March 31, 2011. The facility bears interest at a rate of 6.2% up until March 2011. Beginning in March 2011, the loan is repayable in equal installments over 7 years and bears interest at a rate of 7.1%.

Interest has been calculated at 7.6% using the effective interest rate method. The accretion and financing charges related to changes in expected cash flows recorded as an increase to long-term debt for three months ended March 31, 2011, was $254 (three months ended March 31, 2010: nil). As at March 31, 2011 there were $431 in borrowing costs and charges related to changes in expected cash flows remaining to be amortized to the long-term debt.

(b) The credit agreement is a facility for CHF 5.3 million that bears no interest and is repayable based on the timing of production for the lender. Interest has been imputed at 5%.

(c) The convertible debt (“Convertible Note”) is an unsecured convertible note of the Company in the principal amount of $15,000 that matures in April 2015. The Convertible Note bears interest at an annual rate equal to 7%, calculated semi-annually with the first installment due on October 31, 2010.

Commencing April 30, 2010, the holder of the Convertible Note (the "Holder") may, at its option, convert the Convertible Note into common shares at any time until the close of business on the last business day prior to maturity. The conversion price shall be equal to $20.00 per share.

The Company may redeem the Convertible Note on or after April 30, 2012, at its option and repay in advance this option in whole or in part at par plus accrued and unpaid interest if the volume weighted average trading price of common shares on the TSX during 20 consecutive trading days, is not less than $25.00 per share.

The Company has initially recorded a liability portion of $12,969 and an equity portion of $2,031 in contributed surplus. The liability portion was valued using a 10.8% initial interest rate. Accretion of $86 has been recorded as an increase in the long-term debt for the three months ended March 31, 2011 (three months ended March 31, 2010: nil).

In October 2010, the Holder elected to convert $8,000 of the Convertible Note into 400,000 common shares. As a result, contributed surplus was decreased by $1,083, long-term debt was decreased by $6,996 and share capital was increased by $8,079 for the year ended December 31, 2010.

In February 2011, the Holder elected to convert the remaining $7,000 of the Convertible Note into 350,000 common shares. As a result, contributed surplus was decreased by $948, long-term debt was decreased by $6,415, and share capital was increased by $7,363 for the three months ended March 31, 2011.

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

(d) The credit agreement is a facility for up to $102.4 million, granted to Fortress Specialty Cellulose to support the conversion to dissolving pulp and co-generation capital expenditure programs. At December 31, 2010, $4.7 million has been drawn on this facility. At March 31, 2011, $9.2 million has been drawn on this facility. The facility bears interest at a rate of 5% for the first five years of the loan and at a rate of up to 5.5% for the second five years of the loan. Commencing after two years, the facility is repayable in equal quarterly installments up to June 30, 2020. Interest for the first two years of the credit agreement is added to the principal of the loan. The total interest capitalized and added to the principal up to March 31, 2011 is $122.

Interest has been calculated at 5.6% using the effective interest rate method. The accretion and net gain resulting from the change in cash flow timing was recorded as a decrease in the long-term debt for the three months ended March 31, 2011 in the amount of $88 (three months ended March 31, 2010: nil). As at March 31, 2011 there were $1,002 in borrowing costs and charges related to changes in expected cash flows remaining to be amortized to the long-term debt.

9. SHARE CAPITAL

(a) **Authorized:**

Unlimited number of common shares without par value
Unlimited number of preferred shares with par value $1,000

(b) **Issued and fully paid — common shares**:

	Number of Shares	Share Capital $
Balance, December 31, 2009	10,233,500	59,083
Private placement	1,900,050	42,344
Restricted share units vested (*note 10*)	65,038	684
Options exercised (*note 10*)	85,000	958
Shares issued on redemption of Convertible Note (*note 8*)	400,000	8,079
Balance, December 31, 2010	12,683,588	111,148
Private placement	1,112,050	54,782
Restricted share units vested *(note 10)*	16,968	615
Options exercised *(note 10)*	62,625	685
Shares issued on redemption of Convertible Note *(note 8)*	350,000	7,363
Balance, March 31, 2011	14,225,231	174,593

During the three months ended March 31, 2011, the Company completed a private placement of 1,112,050 shares for total net proceeds of $54,782 after transaction costs of $2,765.

During the year ended December 31, 2010, the Company completed a private placement of 1,900,050 shares for total net proceeds of $42,344 after transaction costs of $2,308.

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

10. STOCK-BASED COMPENSATION

During 2006, the Company adopted a stock incentive plan. The exercise price of options granted under the stock option plan shall be as determined by the Board of Directors when such options are granted, subject to any limitations imposed by any relevant stock exchange or regulatory authority.

At the Company's annual general meeting held April 30, 2009, shareholders approved a long-term incentive plan which provides for the grant of restricted share units, performance share units and deferred share units to key employees and directors of the Company. The aggregate number of shares issuable under the long-term incentive plan in respect of awards, together with shares reserved for issuance under all of the Company's other security-based compensation arrangements, shall not exceed ten percent of the Company's issued and outstanding shares.

Stock Options

In June 2009, options were granted for 35,000 shares which vest over two years to an employee and officer of the Company. The weighted average fair value of the options granted in 2009 was $2.98 an option at the grant date using the Black Scholes option pricing model. No options were granted in 2010 or during the three months ended March 31, 2011. Option pricing models require the input of highly subjective assumptions including the expected volatility. Changes in the assumptions can materially affect the fair value estimate, and, therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options. Assumptions used in the pricing model are as follows:

	2009
Risk-free interest rate	1.78%
Expected life of options	5 years
Annualized volatility	53%
Dividend rate	Nil

Stock option transactions and the number of stock options outstanding are summarized as follows:

	Number of options	**Exercise Price**
Balance, December 31, 2009	740,175	$ 8.00
Exercised	(85,000)	8.00
Balance, December 31, 2010	655,175	$ 8.00
Exercised	(62,625)	8.00
Balance, March 31, 2011	592,550	$ 8.00

As at March 31, 2011, 592,550 stock options were exercisable (December 31, 2010: 643,508). The stock options issued have various vesting dates that range from one to three years from the IPO or grant dates. For the three months ended March 31, 2011, the Company recorded $13 in stock compensation expense and contributed surplus relating to options (March 31, 2010: $68).

Deferred Share Unit Awards

A Deferred Share Unit ("DSU") is a right granted to a non-employee director to receive one common share of the Company, from treasury, on a deferred basis. The value of the DSUs, when redeemed, is equal to the market value of the shares on the redemption date, including the value of dividends paid on the Company's common shares, if any, as if they had been reinvested in additional DSUs on each payment date. The DSUs may only be redeemed upon a director's retirement from the Company. The Company recognizes the expense at the time of grant.

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

DSU transactions and the number of DSUs outstanding are summarized as follows:

	Number of DSUs	Expense recognized $
Balance, December 31, 2009	26,000	185
Granted	121,481	5,134
Redeemed	(8,458)	151
Balance, December 31, 2010	139,023	5,470
Granted	1,953	95
Balance, March 31, 2011	140,976	5,565

Restricted Share Unit Awards

A Restricted Share Unit ("RSU") is a right granted to a key employee to receive one common share of the Company, from treasury, on a time vested basis. The fair value of restricted share awards is determined based upon the number of shares granted and the quoted price of the Company's stock on the date of grant. Restricted shares generally vest over three to five years.

RSU transactions and the number of RSUs outstanding are summarized as follows:

	Number of RSUs
Balance, December 31, 2009	157,626
Granted	222,454
Vested	(65,038)
Balance, December 31, 2010	315,042
Granted	17,128
Vested	(16,968)
Balance, March 31, 2011	315,202

For the three months ended March 31, 2011, $435 (March 31, 2010: $176) was recorded as stock compensation expense and contributed surplus. As at March 31, 2011, the total remaining unrecognized compensation cost related to RSUs amounted to $6,338, which will be amortized over their remaining vesting period.

11. ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income is comprised of cumulative translation adjustments for all periods presented.

(Canadian dollars, amounts in thousands except share and per share data, unaudited)

12. SEGMENTED INFORMATION

The segmentation of the Company's manufacturing operations is based on a number of factors, including production, production processes, and economic characteristics. The Landqart mill and Fortress Optical Features produce security papers and products. The Dresden mill produces non-woven wallpaper base products. Fortress Specialty Cellulose produces pulp products.

	Three months ended March 31, 2011				
	Wallpaper	Security	Pulp	Corporate	Fortress Paper Consolidated
	$	$	$	$	$
Sales	37,001	12,901	35,586	–	85,488
Operating income (loss)	7,006	(6,643)	(940)	(2,523)	(3,100)
Amortization[1]	(649)	(1,949)	(910)	–	(3,508)
Stock-based compensation[1]	–	–	–	(543)	(543)
Capital expenditures	1,990	12,961	12,919	–	27,870
Total assets	141,435	116,826	37,107	72,803	368,171

Sales by geographic area	%
Europe	58.1
North America	3.5
Asia	34.5
Other	3.9
Total	100.0

[1]Stock-based compensation and amortization are included in operating earnings (loss).

	Three months ended March 31, 2010			
	Wallpaper	Security	Corporate	Fortress Paper Consolidated
	$	$	$	$
Sales	31,192	19,112	–	50,304
Operating income (loss)	5,705	163	(2,438)	3,430
Amortization[1]	(579)	(793)	–	(1,372)
Stock-based compensation[1]	–	–	(303)	(303)
Capital expenditures	2,309	8,778	–	11,087
Total assets	53,530	90,839	5,218	149,587

Sales by geographic area	%
Europe	94.5
Asia	5.4
Total	100.0

[1]Stock-based compensation and amortization are included in operating earnings (loss).

13. SUPPLEMENTARY CASH FLOW INFORMATION

Non cash items

Non cash property, plant and equipment purchases included in accounts payable increased by $28 for the three months ended March 31, 2011 and increased by $783 for the three months ended March 31, 2010.

During the three months ended March 31, 2011, 350,000 common shares of the Company were issued for the redemption of the Convertible Note (note 8).