FORTRESS PAPER LTD

Q1 2013

FOR THE THREEE MONTHS ENDED
MARCH 31, 2013

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. ("we", "our", "us", "Fortress" or the "Company") has been prepared based on information available as at May 13, 2013. The MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements and the notes thereto for the three month period ended March 31, 2013 (available on SEDAR at www.sedar.com). This MD&A provides a review of the significant developments that have impacted the Company's performance during the quarter ended March 31, 2013 relative to the previous quarter and prior year comparative quarter. The financial information contained herein has been prepared in accordance with International Financial Reporting Standards ("IFRS"), including IAS 34, Interim Financial Reporting, which as of January 1, 2011 is the required reporting framework for Canadian publicly accountable enterprises.

This MD&A contains certain forward-looking information that reflects the current views and/or expectations of the Company with respect to its expectations, beliefs, assumptions, estimates and forecasts about its business and the industries and markets in which it operates. The reader is cautioned that statements comprising forward-looking information are not guarantees of future performance and involve known and unknown risks, uncertainties, assumptions and other factors which are difficult to predict and that may cause actual results or events to differ materially from those anticipated in such forward-looking information. Accordingly, readers should not place undue reliance on forward-looking information. Examples of such forward-looking information that may be contained in this document include statements regarding: growth and future prospects of our business; market conditions for dissolving pulp and our other products; expected returns on certain business segments; availability of funds for debt allocation; our perceptions of the industry and markets in which we operate and anticipated trends in such markets and in the countries in which we do business; benefits that may accrue to the Company as a result of certain acquisitions, dispositions, capital expenditure programs, equipment upgrades and maintenance shutdowns, as well as the "Operating Excellence" program at the Fortress Specialty Cellulose mill; and the anticipated benefits, cost, timing and completion dates for projects.

Assumptions underlying the Company's expectations regarding forward-looking information contained in this MD&A include, among others: that the Company will be able to effectively market its products; the ability of the Company to complete the ramp-up of its dissolving pulp production at the Fortress Specialty Cellulose mill to reach maximum capacity; the ability of the Company to realize additional savings and efficiencies at the Fortress Specialty Cellulose mill from its "Operating Excellence" program; that there will be no further delays and disruptions affecting the completion of the Fortress Specialty Cellulose mill cogeneration facility and that the Company will be able to commence timely delivery of power therefrom; that dissolving pulp will experience improved and sustained demand in the marketplace at favourable prices; that the Landqart mill will continue operating on a consistent and regular basis in order to produce and deliver on its banknote orders; the general stability of the economic, political and regulatory environments within the countries where the Company conducts operations; the ability of the Company to obtain financing (if necessary) on acceptable terms; that interest and foreign exchange rates will not vary materially from current levels; that all necessary approvals, arrangements and engineering designs will be obtained, finalized and/or completed in a satisfactory manner in order to support a decision to proceed with the Fortress Global Cellulose mill project; and that our equipment will operate at expected levels.

Persons reading this MD&A are cautioned that statements comprising forward-looking information are only predictions, and that the Company's actual future results or performance are subject to certain risks and uncertainties including, without limitation: those relating to potential disruptions to production and delivery, including as a result of equipment failures, labour issues, the complex integration of processes and equipment and other factors; labour relations; failure to meet regulatory requirements; changes in the market; potential downturns in economic conditions; fluctuations in the price and supply of required materials; fluctuations in the market price for products sold; foreign exchange fluctuations; trade restrictions or import duties imposed by foreign governments; availability of financing (as necessary); dependence on major customers; and other risk factors detailed in our Annual Information Form dated March 28, 2013 available on SEDAR at www.sedar.com and other filings with the 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 update any forward-looking information, except as required by applicable securities 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 metric to evaluate profitability. Reference is also made to adjusted net (loss) income (calculated as net (loss) income less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the tables titled "Net Loss to Adjusted Net Loss Reconciliation") 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 (loss) or cash flows as determined in accordance with IFRS. 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 IFRS are included in this MD&A.

All references in this MD&A to "dollars" or "$" are to Canadian dollars, "€" are to the Euro currency unit, "CHF" are to Swiss francs and "US$" are to United States dollars.

Market and industry data contained in this MD&A is based upon information, surveys or studies conducted by independent third parties and independent industry or general publications and the Company's knowledge of, and experience in, the markets in which it operates. The Company has no reason to believe that such information is false or misleading in any material respect, however market and industry data is subject to variation and cannot be verified with complete certainty due to limits on the availability and reliability of raw data, the voluntary nature of the data gathering process and other limitations and uncertainties inherent in any statistical survey. This information has not been independently verified by the Company, or any of its respective directors, officers or representatives or any other person involved in the preparation of the MD&A and no representation is given as to the accuracy of any of the data referred to in this MD&A obtained from third party sources.

Description of Business

The Company was incorporated on May 30, 2006 under the laws of the Province of British Columbia. During the three months ended March 31, 2013, the Company operated internationally in three distinct business segments: the Dissolving Pulp Segment, the Security Paper Products Segment, and the Specialty Papers Segment. The Specialty Papers Segment was sold subsequent to the completion of the first quarter of 2013. Accordingly, references in this MD&A to "discontinued operations" refer to the Specialty Papers Segment.

The Company operates its dissolving pulp business at the Fortress Specialty Cellulose mill located in Canada, which is also in the process of expanding into the renewable energy generation sector with the construction of a cogeneration facility. The Company is also seeking to expand its dissolving pulp capacity with the recent acquisition of the Fortress Global Cellulose mill located at Lebel-sur-Quévillon, Québec, which the Company is evaluating to convert into a dissolving pulp mill and re-start the cogeneration facility. The Company operates its security paper products business at the Landqart mill located in Switzerland, where it produces banknote, passport, visa and other brand protection and security papers, and at its high security production and research facility located in Canada, where it manufactures optically variable thin film material. The segmentation of the Company's manufacturing operations is based on a number of factors, including production, production processes, and economic characteristics. Fortress' business segments were re-classified in 2012 given changes in the nature of products being produced.

The Company previously operated its specialty papers business at the Dresden mill located in Germany, where it was a leading international producer of specialty non-woven wallpaper base products. On April 30, 2013, the Company completed the sale of the Dresden mill and no longer operates in the specialty papers industry (see "Significant Developments").

Overall Performance

EBITDA loss (including discontinued operations) for the Company was $2.6 million for the three months ended March 31, 2013. For the three months ended December 31, 2012, EBITDA (including discontinued operations) was $0.2 million and for the three months ended March 31, 2012, EBITDA loss (including discontinued operations) was $2.0 million.

Excluding corporate costs, combined EBITDA loss of the three business segments Fortress operated in during the first quarter of 2013 was $0.3 million in the three months ended March 31, 2013. The Specialty Papers Segment contributed $10.5 million EBITDA, while the Dissolving Pulp Segment and the Security Paper Products Segment generated EBITDA losses of $8.7 million and $2.1 million, respectively. Corporate costs contributed to EBITDA loss in the amount of $2.3 million.

Fortress reported a net loss (including discontinued operations) of $12.4 million, or diluted loss per share of $0.85 for the first quarter of 2013 on sales of $99.7 million. In the fourth quarter of 2012, the Company reported a net loss of $4.2 million or diluted loss per share of $0.29 on sales of $96.1 million, and for the first quarter of 2012 net loss of $10.7 million or diluted loss per share of $0.75 on sales of $61.4 million.

Fortress reported a net loss from continuing operations of $18.8 million, or diluted loss per share of $1.30 for the first quarter of 2013 on sales of $57.6 million. In the fourth quarter of 2012, the Company reported a net loss of $9.8 million or diluted loss per share of $0.68 on sales of $58.7 million, and for the first quarter of 2012 net loss of $14.2 million or diluted loss per share of $0.99 on sales of $23.7 million.

The Fortress Specialty Cellulose mill commenced production of dissolving pulp in early December 2011. Commercial production for accounting purposes, with the equipment operating as intended by management, began on March 18, 2012. After such date all sales and cost of sales have been included in the operating results. The mill is still considered to be in ramp up mode working towards full capacity and operating efficiencies. Although market prices for dissolving pulp improved in the first quarter of 2013, our sales in one quarter are typically secured by the end of the previous quarter. The combination of the lower realized dissolving pulp prices and challenges experienced at the mill contributed to disappointing results in the first quarter of 2013.

The Security Paper Products Segment had its best quarterly result in the past two years. Metrics continue to improve as the mill experienced its highest sales volumes and revenues relative to any comparative period in 2012 and 2011. However, less than favourable conditions, including impacts on our business as a result of the strength of the Swiss franc against the Euro, overcapacity in the banknote paper industry and increased competition for orders continue to adversely impact the results of the Security Paper Products Segment.

The Specialty Papers Segment, which has been discontinued, had a strong first quarter. See "Significant Developments" for an update on the sale of the Dresden mill.

Management's Outlook

Dissolving Pulp Segment

Dissolving pulp markets improved during the first quarter of 2013 but remain challenging due to continued excess supply. The market price of dissolving pulp in China, as reported by China Chemical Fibers & Textiles Consultancy Group (CCF), a leading professional data analysis company relied upon in the dissolving pulp industry, improved from December lows of US$830-840 per air dried metric tonne (ADMT) to approximately US$930 per ADMT in February and March. Management believes that current depressed dissolving pulp prices are indicative of unusual market conditions and are not sustainable, as the global industry has been experiencing mill shutdowns and mills swinging capacity to produce paper pulps. We expect that dissolving pulp prices will remain under pressure until new expected capacity is absorbed.

Viscose staple fibre demand in China has been stable in the first quarter of 2013 as operating rates remain healthy, although fibre prices weakened at the end of March. Cotton prices remained relatively stable in China during the first quarter of 2013. However, when compared to 2011, cotton prices still remain low which could lead to possible cotton crop plantation reductions in 2013. Cotton reserve management, particularly in China, may affect future cotton pricing.

The Fortress Specialty Cellulose mill pulp production rates remained below management expectations during the first quarter of 2013 as the mill faced on-going challenges with digester and evaporator capacity issues. The mill recently completed a ten day maintenance shut down that began in late April. We expect that the maintenance shut down will address issues in order to improve production, generate stable operations and reduce production costs. Finished goods inventory levels at the end of the first quarter were minimal.

The cogeneration project continues in its commissioning and start-up phase. Power generation is expected by the end of the second quarter following the completion of testing and adjustments.

Although depressed dissolving pulp prices have impacted the Fortress Specialty Cellulose mill results, the Company is continuing the implementation of its comprehensive “Operating Excellence” program designed to improve overall efficiency and productivity. In parallel, we have commenced an aggressive cost reduction program. In the third quarter of 2013 we expect to realize significant benefits from production improvements, cost reduction initiatives and the cogeneration facility. In addition the Company has strengthened mill management and with new leadership expects to make material progress towards targets over the remainder of the year.

The Fortress Global Cellulose (“FGC”) mill project continues to advance. Engineering design for the conversion to produce dissolving pulp is near completion with an updated capital expenditure estimate of $250 million plus or minus 10%. A comprehensive review of the overall project is ongoing. We have incorporated learnings from our Thurso capital projects including a more gradual ramp-up curve. This results in additional cash requirements of $70-$100 million for working capital, including start-up costs, raw materials, inventory and various other items, to fund the entire FGC mill project and its operational ramp-up. As a result, the Company is evaluating options for different sources of funds to cover increased budgeted capital expenditures and provide ramp-up working capital. Final budgeted costs and financial models are being further refined.

The Company is currently in the process of exploring strategic options to mitigate the financial risk, including alternative financing structures, joint ventures and partnership opportunities. While the project economics continue to be attractive, the Company will be comparing the FGC mill investment opportunity to other strategic options for shareholder value creation. Due to changing economics and market conditions, there is no assurance that the FGC mill project will proceed to completion as previously planned. The Company intends to report its decision regarding the strategic direction of the FGC mill early in the third quarter.

Security Paper Products Segment

The Security Paper Products Segment continues to be adversely impacted by a strong Swiss franc relative to the Euro and overcapacity in the industry resulting in fierce competition for tenders. Despite these difficulties, Landqart has a strong order book with good visibility well into the second half of the year. The mill is currently operating at full capacity. Estimated volumes to be produced and sold in 2013 are expected to be significantly higher than in 2012. Landqart is now producing its second order of its new composite paper-polymer-paper substrate Durasafe® and is pursuing several more sales opportunities for this new product. This second order of Durasafe® includes security threads from Fortress’ optical thin film division. Landqart has also been awarded paper orders in several new markets during the first quarter of 2013. These orders are expected to be produced and delivered later this year.

The Landqart mill has substantially completed the majority of the production of its largest banknote order and has delivered over 70% of its contract volume. The Landqart mill is continuing its efforts to enter into new markets to diversify its customer base in preparation for the completion of this contract. The Company is confident that it will continue to meet its sales target through a combination of repeat orders in established markets together with new business. Landqart has improved operational results systematically over the past two quarters and management anticipates this trend to continue through the second quarter of 2013.

Significant Developments

Sale of the Dresden Mill

In March 2013, the Company and its wholly owned subsidiary, Fortress Security Papers AG (“FSP”), entered into a share purchase agreement (the ”Share Purchase Agreement”) with Glatfelter Gernsbach GmbH & Co. KG (“Glatfelter Gernsbach”) and its parent, P.H. Glatfelter Co. (“Glatfelter”), pursuant to which FSP agreed to sell all of the shares of its wholly owned subsidiary, Dresden Papier GmbH (“Dresden”), to Glatfelter Gernsbach for an aggregate purchase price of €160 million (approximately CDN$213 million), subject to a working capital adjustment. Pursuant to the terms of the Share Purchase Agreement, the Company agreed to guarantee the obligations of FSP and Glatfelter agreed to guarantee the obligations of Glatfelter Gernsbach thereunder.

The sale of the Dresden mill completed on April 30, 2013. Net proceeds received from the sale, after closing working capital adjustments and the settlement of Dresden’s outstanding loans, guarantees and factoring arrangements with

Commerzbank AG and CommerzFactoring GmbH, as applicable, were approximately €120 million (approximately $159 million), which is subject to post closing working capital and tax adjustments.

With the sale of the Dresden mill, the Company no longer operates in the Specialty Papers (wallpaper base) industry.

Selected Quarterly Information

(thousands of dollars, except per share amounts, exchange rates and shares outstanding, unaudited)	**Q1 2013**	**Q4 2012**	**Q3 2012**	**Q2 2012**
Sales from continuing operations	57,559	58,748	38,256	43,209
Net (loss) income from continuing operations	(18,814)	(9,829)	(23,994)	5,928
Net (loss) income (1)	(12,373)	(4,227)	(19,060)	12,291
Basic net (loss) income per share from continuing operations	($1.30)	($0.68)	($1.67)	$0.41
Diluted net (loss) income per share from continuing operations	($1.30)	($0.68)	($1.67)	$0.39
Basic net (loss) income per share (1)	($0.85)	($0.29)	($1.32)	$0.86
Diluted net (loss) income(1)	($0.85)	($0.29)	($1.32)	$0.81
Weighted average shares outstanding - Basic (thousands)	14,502	14,492	14,394	14,322
Weighted average shares outstanding - Diluted (thousands)	14,502	14,492	14,394	15,118
Average Swiss/Canadian exchange rate(2)	1.0837	1.0645	1.0340	1.0784
Average Euro/Canadian exchange rate (2)	1.3312	1.2857	1.2445	1.2956
Average US dollar/Canadian exchange rate (2)	1.0083	0.9913	0.9953	1.0105

(thousands of dollars, except per share amounts, exchange rates and shares outstanding, unaudited)	**Q1 2012**	**Q4 2011**	**Q3 2011**	**Q2 2011**
Sales from continuing operations	23,711	14,644	48,218	53,337
Net (loss) income from continuing operations	(14,206)	(14,340)	(11,039)	(1,492)
Net (loss) income (1)	(10,670)	(9,171)	(7,237)	2,905
Basic net (loss) income per share from continuing operations	($0.99)	($1.00)	($0.77)	($0.10)
Diluted net (loss) income per share from continuing operations	($0.99)	($1.00)	($0.77)	($0.10)
Basic net (loss) income per share(1)	($0.75)	($0.64)	($0.51)	$0.20
Diluted net (loss) income(1)	($0.75)	($0.64)	($0.51)	$0.19
Weighted average shares outstanding - Basic (thousands)	14,306	14,298	14,260	14,232
Weighted average shares outstanding - Diluted (thousands)	14,306	14,298	14,260	15,145
Average Swiss/Canadian exchange rate(2)	1.0871	1.1216	1.1911	1.1147
Average Euro/Canadian exchange rate (2)	1.3129	1.3790	1.3843	1.3937
Average US dollar/Canadian exchange rate (2)	1.0011	1.0232	0.9807	0.9679

(1) Including discontinued operations
(2) Source – Bank of Canada (average noon rate for the period).

Fluctuations in quarterly results reflect significant transactions and developments within the Company. In the second quarter of 2011, the Dissolving Pulp Segment realized significantly higher prices for specialty pulp relative to the third quarter of 2011. In the fourth quarter of 2011, the Dissolving Pulp Segment was re-defined as the Fortress Specialty Cellulose Mill transitioned from a northern bleached hardwood kraft pulp producer to a dissolving pulp producer. Results were impacted by the mill being in either shutdown or ramp-up mode for much of the fourth quarter of 2011 with production of dissolving pulp commencing in December 2011. Start-up continued through the first quarter of 2012 with all dissolving pulp revenue and costs for production from December 2011 through March 18, 2012 being capitalized in property, plant and equipment for accounting purposes. Throughout the remainder of 2012, the Dissolving Pulp Segment continued ramping up and improving production rates albeit at a slower pace than first anticipated. In the third quarter of 2012, the Fortress Specialty Cellulose mill had its annual extended maintenance shutdown, as well as an unplanned outage due to a temporary recovery boiler issue which both contributed to lower shipments and production during the quarter.

During the fourth quarter of 2012, the Dissolving Pulp Segment saw stable production with the highest volumes of dissolving pulp produced during a quarter to date. As such, sales were higher, but continued deterioration in dissolving pulp prices impacted earnings to overshadow improved production. The first quarter of 2013 in the Dissolving Pulp Segment was characterized by production challenges and the lowest realized dissolving prices experienced to date, which contributed to disappointing results.

Product mix, high raw material costs, pricing pressure, a strong Swiss currency, and less than optimal production efficiency at the Landqart mill contributed to a disappointing and difficult 2011 year for the Security Paper Products Segment which materially impacted the Company's quarterly results throughout 2011 and 2012. Net income for the second quarter of 2012 was significantly impacted by the sale of the hydropower assets and associated real estate at the Landqart mill to a Swiss utility company for proceeds of CHF18 million. An increase in volume sold in the first quarter of 2013 has contributed to improving metrics, higher sales and better results for the Security Paper Products Segment. In addition the results were positively impacted by a $1.9 million realized gain from the sale of non-core assets.

The Specialty Papers Segment, now discontinued, continued to produce strong results in the first quarter of 2013.

First Quarter 2013 Operations Review

Three Months Ended March 31

Overview

Fortress reported an adjusted net loss from continuing operations of $20.6 million, or diluted adjusted loss per share of $1.42 for the first quarter of 2013 on sales of $57.6 million. In the fourth quarter of 2012, the Company reported an adjusted net loss of $11.1 million or diluted adjusted loss per share of $0.77 on sales of $58.7 million and for the first quarter of 2012 adjusted net loss of $15.4 million or diluted loss per share of $1.08 on sales of $23.7 million.

Sales and cost of products sold in the first quarter are comparative to the previous quarter; however, the net loss was significantly impacted in the first quarter of 2013 by higher selling, general and administrative ("SG&A") expenses as well as a higher deferred income tax recovery recorded in the fourth quarter of 2012. In the first quarter of 2012 the Dissolving Pulp Segment was in a start-up phase for accounting purposes through to mid-March; whereby, approximately $7.1 million of net costs were capitalized to property, plant and equipment.

Cost of products sold was $60.9 million for the three months ended March 31, 2013 compared to $61.3 million for the three months ended December 31, 2012. In the first quarter of 2012, cost of products sold was $26.7 million.

SG&A expenses were $9.8 million for the first quarter of 2013 compared to $6.6 million for the fourth quarter of 2012. The prior year comparative period SG&A was $8.3 million. The increased level of SG&A relative to the prior period was due primarily to increased corporate activity related to the Dresden sales process and higher commissions in the Security Paper Products Segment. Adjusting for these items, SG&A would be comparable to prior comparatives.

Stock-based compensation expense was $0.9 million during the period compared to $0.6 million in the fourth quarter of 2012. The prior year comparative period stock-based compensation was $0.4 million. Stock compensation was higher in the first quarter of 2013 relative to the prior period comparatives primarily as a result of stock option awards that vested for a departing executive.

Selected Financial Information and Statistics

(thousands of dollars, except shipments, unaudited)	**Q1 2013**	**Q4 2012**	**Q1 2012**
Sales from continuing operations	57,559	58,748	23,711
EBITDA from continuing operations[1]	(13,162)	(9,023)	(11,333)
EBITDA[2] [3]	(2,627)	242	(1,987)
Net loss from continuing operations	(18,814)	(9,829)	(14,206)
Net loss [3]	(12,373)	(4,227)	(10,670)
Adjusted net loss from continuing operations [4]	(20,618)	(11,138)	(15,436)
Paper shipments (tonnes) [5]	2,179	1,688	995
Pulp shipments (ADMT)	39,147	46,909	35,682

(1) See Net Loss to EBITDA Reconciliation for Continuing Operations.
(2) See Net Loss to EBITDA Reconciliation including Discontinued Operations.
(3) Including discontinued operations.
(4) See Net Loss to Adjusted Net Loss Reconciliation for Continuing Operations.
(5) From continuing operations.

Net Loss to Adjusted Net Loss Reconciliation for Continuing Operations:

(thousands of dollars, except per share amounts, unaudited)	**Q1 2013**	**Q4 2012**	**Q1 2012**
Net loss	(18,814)	(9,829)	(14,206)
Foreign exchange loss (gain)	56	(1,309)	(1,230)
Non-core asset sale	(1,860)	-	-
Adjusted net loss	(20,618)	(11,138)	(15,436)
Basic and diluted net loss per share	(1.30)	(0.68)	(0.99)
Adjusted net loss per share, basic and diluted	(1.42)	(0.77)	(1.08)

Net Loss to EBITDA Reconciliation for Continuing Operations:

(thousands of dollars, unaudited)	**Q1 2013**	**Q4 2012**	**Q1 2012**
Net loss	(18,814)	(9,829)	(14,206)
Income tax	(1,815)	(5,779)	(1,141)
Foreign exchange loss (gain)	56	(1,309)	(1,230)
Net finance expense	4,009	3,049	1,705
Amortization	4,334	4,215	3,128
Non-core asset sale	(1,860)	-	-
Stock based compensation	928	630	411
EBITDA	(13,162)	(9,023)	(11,333)

Net Loss to EBITDA Reconciliation Including Discontinued Operations:

(thousands of dollars, unaudited)	Q1 2013	Q4 2012	Q1 2012
Net loss	(12,373)	(4,227)	(10,670)
Income tax	1,144	(3,375)	642
Foreign exchange loss (gain)	81	(1,293)	(1,208)
Net finance expense	4,373	3,391	4,841
Amortization	5,080	5,116	3,997
Non-core asset sale	(1,860)	-	-
Stock based compensation	928	630	411
EBITDA	(2,627)	242	(1,987)

Operating Results by Business Segment

Dissolving Pulp Segment

(thousands of dollars, except for shipments, unaudited)	Q1 2013	Q4 2012	Q1 2012
Sales	28,886	35,764	10,435
Operating loss	(11,026)	(5,776)	(4,697)
Shipments (ADMT)	39,147	46,909	35,682

In the first quarter of 2013 the Fortress Specialty Cellulose mill experienced production challenges related to the digester and evaporator that stalled progress experienced in the previous quarter. Compounding the impact on results was the lowest realized sales prices to date due to weakening market prices of dissolving pulp in China. The first quarter of 2012 could be characterized as a dissolving pulp start-up quarter when approximately $7.1 million net costs were capitalized to property, plant and equipment through to mid-March.

With the cogeneration facility expected to go online prior to the end of the second quarter of 2013 and after the planned ten day maintenance shut-down, which is anticipated to resolve production issues, costs are expected to improve significantly in the third quarter of 2013.

Security Paper Products Segment

(thousands of dollars, except for shipments, unaudited)	Q1 2013	Q4 2012	Q1 2012
Sales	28,673	22,983	13,275
Operating loss	(4,122)	(6,953)	(7,356)
Shipments (tonnes)	2,179	1,688	995

Results in the first quarter of 2013 reflect concerted efforts at the Landqart mill to continue improvement of production efficiencies. Despite such improvements, less than favourable conditions that adversely impacted results in the fourth quarter of 2012, such as the strength of the Swiss franc against the Euro, overcapacity in the banknote paper industry and increased competition for orders, continued to adversely impact results in the first quarter of 2013. However, the mill experienced its highest sales volumes and revenues relative to any comparative period in 2012 and 2011, which contributed to more efficient operations.

In the first quarter of 2012, the Landqart sales volume and results were adversely impacted by delays in the implementation of a significant bank order which was reinstated late in the second quarter of 2012.

The Company continues to assess other strategic options at the Landqart mill, including the sale of non-core assets. Non-core land sales resulted in proceeds of $3.6 million and a realized gain of $1.9 million in the quarter. This gain is not included in EBITDA or operational income.

Fortress Optical Features Ltd. ("Fortress Optical") generated sales of $0.5 million in the first quarter of 2013 and $0.1 million in the fourth quarter of 2012. In the first quarter of 2012, no sales revenue was generated. Fortress Optical began operations in 2011. Fortress Optical produces security material for security threads used in banknotes at the Fortress Optical Facility.

Discontinued Operations: Specialty Papers Segment

(thousands of dollars, except for shipments, unaudited)	Q1 2013	Q4 2012	Q1 2012
Sales	42,102	37,349	37,658
Operating income	9,789	8,448	8,563
Shipments (tonnes)	16,008	14,694	14,295

Selected Cash Flow Items

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Cash (used by) provided before working capital changes	(5,612)	(4,237)
Non-cash working capital change	1,628	15,008
Cash provided (used by) operating activities	(3,984)	10,771
Cash provided from financing activities	15,183	18,736
Additions to property, plant and equipment	(17,727)	(38,065)
Other	4,433	(7,082)
Cash used by investing activities	(13,294)	(45,147)
Change in cash position	(2,095)	(15,640)
Foreign exchange loss on cash and cash equivalents	282	(497)

Operating Activities

Fortress operates in a cyclical industry and its operating cash flows vary accordingly. Fortress' principal operating cash expenditures are for compensation and raw materials. Operating activities used cash of $4.0 million and provided cash of $10.8 million in the three months ended March 31, 2013 and 2012, respectively.

Working capital is subject to cyclical operating needs, the timing of collection of receivables and the payment of payables and expenses. The movement in the first quarter of 2013 is primarily a result of increased accounts receivables and slightly lower accounts payable, accrued liabilities and other which were more than offset by lower inventory. The movement in the first quarter of 2012 is primarily a result of the combination of lower accounts receivable and inventory offset in part by lower accounts payable and other.

Financing Activities

During the first quarter of 2013, financing activities generated $15.2 million. Dresden entered into two credit facilities in the aggregate amount of €15 million with Commerzbank AG. The new facilities were comprised of a €5 million tranche and a €10 million tranche which have been repaid subsequent to the quarter end, together with all other outstanding Dresden indebtedness, as a condition of and concurrently with the closing of the sale of Dresden. Repayment of debt and interest used cash of $2.9 million and $1.8 million, respectively, in the first quarter of 2013.

During the first quarter of 2012, financing activities generated $18.7 million. Cash was generated by drawing on the Company's loan agreement with Investissement Quebec ("IQ") in respect of the Fortress Specialty Cellulose mill project. During the quarter the Company entered into a new €25 million credit facility with Commerzbank AG. The facility was used primarily to repay the balance of an existing loan agreement with GE Capital Bank AG that was used to finance the rebuild of papermachine no.1 at the Landqart mill. A penalty of $2.6 million was paid in connection with the early repayment of the GE indebtedness.

Investing Activities

Investing activities in the first quarter of 2013 and 2012 used cash of $13.3 million and $45.1 million, respectively as capital expenditures in the Dissolving Pulp Segment abate. Investment activities relating to the purchase of equipment and other capital expenditures at the mills was $17.7 million for the first quarter of 2013 and $38.0 million in the first quarter of 2012. Proceeds received for the sale of non-core assets in the Security Paper Products Segment generated cash of $3.6 million. In addition, restricted cash decreased by $0.8 million. Cash used in investing activities for the first quarter of 2012 was negatively impacted by the $7.1 million of start-up costs capitalized.

Liquidity and Capital Resources

As at March 31, 2013, the Company has made aggregate expenditures of approximately $230.7 million, including $14.6 million in accounts payable, on the conversion of Fortress Specialty Cellulose mill into a dissolving pulp mill and the construction of a new cogeneration facility. As at the date of this MD&A, aggregate expenditures on the Fortress Specialty Cellulose mill project were approximately $232.3 million, including $10.3 million in accounts payable. In the latter part of the first quarter of 2012, management reassessed the cogeneration project and identified certain deficiencies in a previous estimate from an engineering firm as well as scope of work adjustments necessary in order to commence delivery of power early in 2013. Additional costs were incurred as a result of repairs required to the recovery boiler during the third quarter of 2012. Subsequent to the 2012 year end, the Company announced that commissioning and start-up activities relating to the cogeneration project at the Fortress Specialty Cellulose mill had incurred delays as a result of various factors, including unforeseen piping related delays, reduced manpower availability and minor scope of work adjustments. As a result of these and other previously reported issues, the current budgeted capital expenditures remaining to complete the Fortress Specialty Cellulose mill project as a whole, as at the date of this MD&A, are approximately $2.7 million in addition to the amounts in accounts payable. The Company expects delivery of power to commence before the end of the second quarter of 2013.

Although there can be no assurances, Fortress believes that current cash, cash generated from operations, tax credits, proceeds from the divestiture of non-core assets, proceeds from the 2012 Debenture Offering, together with amounts available under its existing or new credit facilities should be sufficient to meet its debt service, capital expenditure and short term working capital requirements. Fortress' future operating performance and its ability to finance capital expenditures, service its debt and pay other indebtedness will be subject to future economic conditions, the financial success of Fortress' business, the successful ramp-up of its dissolving pulp production at the Fortress Specialty Cellulose mill to full planned capacity combined with the cost benefits expected to be derived from the cogeneration facility once it is operational and other factors, some of which are not within Fortress' control, including but not limited to changes in market prices for its products, raw materials costs and foreign currency exchange rates. Although the ramp-up of dissolving pulp production to planned capacity at the Fortress Specialty Cellulose mill is anticipated to provide significant cash flow and liquidity, Fortress may determine, in its sole discretion, that market or financial conditions may warrant that it seek additional sources of capital on terms satisfactory to Fortress, including but not limited to additional debt or equity financing, in order to fund capital expenditures, provide additional working capital, enhance liquidity or for other general corporate purposes. See "Risks and Uncertainties" in the Company's Management's Discussion and Analysis for the year ended December 31, 2012, available on SEDAR.

At March 31, 2013, the Company had cash of $29.7 million and aggregate indebtedness of $273.2 million. Included in this indebtedness is $98.3 million drawn on the $102.4 million credit facility with IQ in respect of the Fortress Specialty Cellulose mill project. The remaining balance has been reported as "Other accounts receivable" since it represents an amount contractually owing to the Company by IQ under the credit facility, which provides that the Company is able to draw down on its loan after it confirms to IQ that certain qualifying capital expenditures have been made and fully paid. Subsequent to the quarter end, the remaining balance has been drawn. Under this credit facility, the Company has, at its discretion, the right to defer a limited number of principal payments. The Company has exercised its right and elected to defer 2013 principal payments without penalty.

Commitments

As at March 31, 2013 the Company has:

- committed to purchase $8.2 million in property, plant, and equipment; and,
- performance bonds in the amounts of €6.4 million and CHF 0.1 million,
- committed to purchase steam from a supplier up to the end of 2015 for CHF 0.9 million per year.

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 relevant stakeholders to ensure the safety of its operations and employees, and remain in compliance with applicable environmental regulations and enhance the communities in which it operates.

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

The Company's capital comprises of net debt and shareholders' equity:

	March 31, 2013 $	**December 31, 2012 $**
Cash and cash equivalents	29,678	31,491
Less total debt	273,192	255,901
Net (debt) cash	(243,514)	(224,410)
Shareholders' equity	218,625	229,669

The Company has certain financial covenants stipulating maximum net debt to capitalization ratios, maximum debt to earnings before interest, taxes, depreciation and amortization ratios, and minimum current ratios. Debt obligations are owed by various entities within the organization with individual loan agreements specifying the entities within the group of companies that are to be included in the covenant calculations.

The Company ensures it remains in compliance with all of its existing debt covenants in order to facilitate future access to capital. Management reviews past results and forecasts to monitor their compliance. The Company was in compliance with all externally imposed capital requirements for the quarter ended March 31, 2013.

Outstanding Shares

The number of common shares outstanding at March 31, 2013 and the date of this report was 14,507,586 and 14,509,586, respectively. The number of options outstanding at March 31, 2013 and the date of this report was 650,725. At March 31, 2013 and the date of this report, there were 261,191 and 277,952 restricted share units outstanding, respectively. At March 31, 2013 and the date of this report there were 157,212 and 164,320 deferred share units outstanding, respectively.

Related Party Transactions

Related party transactions consist of remuneration of directors and other key management personnel with whom we have entered in employment agreements. Further information is contained in our Management Information Circular dated May 3, 2013, which is available on SEDAR at www.sedar.com.

Contingencies

Provisions for liabilities relating to legal actions and claims require judgments using management's best estimates regarding projected outcomes and the range of loss, based on such factors as historical experiences and recommendations of legal counsel. Actual results may vary from estimates and the differences are recorded when known. In respect of a dispute which arose in the fourth quarter of 2011 relating to a faulty input which was provided by a third party supplier of the Landqart mill, the Company expected that any amounts under dispute would be reimbursed to the Company by the supplier. The net impact to the mill is therefore expected to be nil. Subsequent to the quarter end the Company has agreed on satisfactory payment terms with the supplier to recover the entire amount.

Critical Accounting Estimates

For a review of significant management judgments affecting financial results and critical accounting estimates, see the Management's Discussion and Analysis for the year ended December 31, 2012, available on SEDAR.

New Accounting Pronouncements

On January 1, 2013 the Company adopted new and amended accounting standards as disclosed in Note 3 to the unaudited condensed consolidated interim financial statements.

Risks and Uncertainties

A comprehensive discussion of risk factors is included in the Company's 2012 Annual Information Form dated March 28, 2013, available on SEDAR at www.sedar.com. Those as well as risks detailed in the Management's Discussion and Analysis for the year ended December 31, 2012, also available on SEDAR, may impact the business of the Company.

Disclosure Controls and Internal Controls over Financial Reporting

During the quarter ended March 31, 2013, 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.

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

	Note	March 31, 2013 $	December 31, 2012 $
ASSETS			
Current			
Cash and cash equivalents		29,678	31,491
Restricted cash		1,225	2,600
Trade accounts receivable		17,467	13,835
Other accounts receivable	4	19,158	28,403
Inventories		32,926	53,064
Prepaid expenses	7	9,109	8,334
Assets held for sale	5	53,520	–
		163,083	137,727
Property, plant and equipment		424,078	440,227
Total assets		587,161	577,954
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities		69,176	79,806
Income taxes payable		–	3,123
Current portion of long-term debt	7	14,288	7,761
Liabilities held for sale	5	18,480	–
		101,944	90,690
Long-term debt	7	258,904	248,140
Provisions and other long term liabilities		5,638	5,528
Deferred income taxes		1,686	2,154
Employee future benefits	3	364	1,773
Total liabilities		368,536	348,285
Shareholders' equity			
Share capital	8	178,317	178,052
Contributed surplus		26,741	26,078
Accumulated other comprehensive income	3	1,271	2,152
Retained earnings	3	12,296	23,387
Total shareholders' equity		218,625	229,669
Total liabilities and shareholders' equity		587,161	577,954
Subsequent events	13		

(See accompanying notes)

Approved by the Board of Directors:

“Chadwick Wasilenkoff” — Director

“Richard Whittall” — Director

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Canadian dollars, amounts in thousands, unaudited)

	Note	Three Months Ended March 31, 2013 $	Three Months Ended March 31, 2012 $
Sales		57,559	23,711
Costs and expenses			
Cost of products sold		(60,925)	(26,733)
Amortization		(4,334)	(3,128)
Selling, general and administration		(9,796)	(8,311)
Stock-based compensation		(928)	(411)
Operating loss		(18,424)	(14,872)
Other income (expense)			
Finance expense		(4,033)	(1,712)
Finance income		24	7
Gain on sale of property, plant and equipment	6	1,860	–
Foreign exchange (loss) gain		(56)	1,230
Net (loss) income from continuing operations before income taxes		(20,629)	(15,347)
Income tax recovery		1,815	1,141
Net loss from continuing operations		(18,814)	(14,206)
Net income from discontinued operations	5	6,441	3,536
Net loss		(12,373)	(10,670)
Loss and diluted loss per share from continuing operations		(1.30)	(0.99)
Loss and diluted loss per share		(0.85)	(0.75)
Weighted average number of shares outstanding			
Basic		14,501,924	14,305,836
Diluted		14,501,924	14,305,836

(See accompanying notes)

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

(Canadian dollars, amounts in thousands, unaudited)

	Three Months Ended March 31, 2013 $	Three Months Ended March 31, 2012 $
Net loss	(12,373)	(10,670)
Other comprehensive loss		
Items that may be reclassified subsequently to net income		
Cumulative translation adjustment	(881)	802
	(881)	802
Items that will not be reclassified to net income		
Actuarial gain recognized on employee future benefits (net of taxes of ($256), and ($243))	1,282	1,211
Total other comprehensive income	401	2,013
Total comprehensive loss	(11,972)	(8,657)

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Canadian dollars, amounts in thousands, unaudited)

	Note	Three Months Ended March 31, 2013 $	Three Months Ended March 31, 2012 $
Share Capital	8		
Balance at beginning of period		178,052	175,200
Restricted share units vested		166	158
Deferred share units vested		99	–
Balance at end of period		178,317	175,358
Contributed Surplus			
Balance at beginning of period		26,078	13,010
Stock based compensation		928	410
Restricted share units vested		(166)	(158)
Deferred share units vested		(99)	–
Balance at end of period		26,741	13,262
Retained Earnings			
Balance at beginning of period, as reported		23,039	40,741
Effect of retroactive adoption of new accounting pronouncement	3	348	340
Balance at beginning of period, restated		23,387	41,081
Net loss		(12,373)	(10,670)
Defined benefit plan actuarial gain, net of tax		1,282	1,211
Balance at end of period		12,296	31,622
Accumulated Other Comprehensive Income			
Balance at beginning of period		2,152	2,688
Cumulative translation adjustment on foreign operations		(881)	802
Balance at end of period		1,271	3,490
Total equity		218,625	223,732

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	Note	March 31, 2013 $	March 31, 2012 $
Cash flows from (used by) operating activities			
Net loss for the period		(12,373)	(10,670)
Adjustments:			
Gain on sale of property, plant and equipment	6	(1,860)	–
Amortization		5,080	3,997
Income tax expense		1,144	643
Income taxes paid		(2,827)	(2,347)
Foreign exchange gain		(102)	(1,123)
Finance expense		4,398	4,853
Stock-based compensation		928	410
		(5,612)	(4,237)
Change in non-cash working capital items			
Accounts receivable		(2,195)	9,295
Inventories		5,617	11,851
Prepaid expenses		(917)	(500)
Accounts payable and accrued liabilities and other		(877)	(5,638)
		(3,984)	10,771
Cash flows from (used by) financing activities			
Repayment of long-term debt		(2,839)	(26,184)
Proceeds from long-term debt		19,860	48,058
Long-term debt prepayment penalty		–	(2,615)
Payment of long-term debt interest		(1,838)	(523)
		15,183	18,736
Cash flows from (used by) investing activities			
Additions to property, plant and equipment		(17,727)	(38,065)
Proceeds from sale of property, plant and equipment	6	3,583	–
Startup costs capitalized		–	(7,072)
Restricted cash		850	(10)
		(13,294)	(45,147)
Decrease in cash position		(2,095)	(15,640)
Foreign exchange (gain) loss on cash and cash equivalents		282	(497)
Cash and cash equivalents, beginning of year		31,491	22,897
Cash and cash equivalents, end of period		29,678	6,760
Supplementary cash flow information	12		

(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 Paper operates internationally in three distinct business segments: dissolving pulp, specialty papers and security paper products. The Company operates its dissolving pulp business at the Fortress Specialty Cellulose Mill located in Canada, which is also in the process of expanding into the renewable energy generation sector with the construction of a cogeneration facility. Fortress Specialty Cellulose was converted into a dissolving pulp mill with ramp up production starting in December of 2011. Commercial production at Fortress Specialty Cellulose for accounting purposes, with the equipment operating as intended by management, began on March 18, 2012. Fortress Specialty Cellulose is still considered to be in ramp up mode working towards full capacity and operating efficiencies. The Company is also seeking to expand its dissolving pulp capacity with the acquisition of the Fortress Global Cellulose Mill located at Lebel-sur-Quévillon, Québec, which the Company intends to convert into a dissolving pulp mill and re-start the cogeneration facility. The Company operates its specialty papers business at the Dresden Mill located in Germany, where it is a leading international producer of specialty non-woven wallpaper base products (*Note 5 and 13)*. The Company operates its security paper products business at the Landqart Mill located in Switzerland, where it produces banknote, passport, visa and other brand protection and security papers, and at its Fortress Optical Facility located in Canada, where it manufacturers optically variable thin film material.

2. BASIS OF PRESENTATION

These condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting*. The Company has consistently applied the same accounting policies throughout all periods presented, as if these policies had always been in effect. The policies applied in these condensed interim consolidated financial statements are based on International Financial Reporting Standards ("IFRS") issued and outstanding as of May 13, 2013, the date the Board of Directors approved the statements.

These unaudited interim financial statements do not include all of the disclosures required by IFRS for annual financial statements and, accordingly, should be read in conjunction with the consolidated financial statements and notes as at and for the year ended December 31, 2012 (available on SEDAR at www.sedar.com). These unaudited interim financial statements follow the same accounting policies and methods of their application as December 31, 2012 consolidated financial statements, with the exception of the changes noted in Note 3 below.

3. NEW ACCOUNTING PRONOUNCEMENTS

IAS 1 – Presentation of Financial Statements

The Company has adopted the amendments to IAS 1 effective January 1, 2013. These amendments required the Company to group other comprehensive income items by those that will be reclassified subsequently to profit or loss and those that will not be reclassified. The Company has reclassified comprehensive income items of the comparative period. These changes did not result in any adjustments to other comprehensive income (loss) or comprehensive income (loss).

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

IAS 19 – Employee Benefits

IAS 19, *Employee Benefits* (Revised 2011), amends certain accounting requirements for defined benefit plans and termination benefits.

The revised standard requires that the net defined benefit liability (asset) be recognized on the statement of financial position excluding any deferral of actuarial gains and losses and past service costs as previously allowed. Past service costs are recognized in net income when incurred. Expected returns on plan assets are no longer included in post-employment benefits' expense; rather, post-employment benefits' expense includes the net interest on the net defined benefit liability (asset) calculated using a discount rate based on market yields on high quality bonds. Adjustments consisting of actuarial gains and losses, the actual return on plan assets (excluding the net interest component) and any change in the asset ceiling are recognized in other comprehensive income. The Company also continues to recognize interest expense (income) on the net post-employment benefits liability (asset) in finance expense (income) in the condensed consolidated statement of operations.

IAS 19 (Revised 2011) also clarifies that benefits are classified as long-term if payments are not expected to be made within the next 12 months. The standard also requires termination benefits to be recognized at the earlier of when the entity can no longer withdraw the offer of the termination benefit or recognizes restructuring costs. Termination benefits that require future services are recognized over the period the future services will be provided.

The Company adopted these amendments retrospectively and has adjusted its opening equity as at January 1, 2012 to recognize an amended employee future benefits liability according to the new standard. The employee future benefits' finance expense and employee benefit expense for the comparable period have been adjusted to reflect the accounting changes for defined benefit plans. There were no changes to the Company for other long-term employment benefits or termination benefits as a result of adopting the amended standard. The adjustments for each financial statement line item are presented in the tables below.

Adjustments to the statement of financial position	December 31, 2012 $	January 1, 2012 $
Equity before accounting change	229,330	231,639
Decrease in employee future benefits liability	407	408
Increase in deferred income tax liability	(68)	(68)
Equity after accounting change	229,669	231,979

Adjustments to the statement of operations	Three Months Ended March 31, 2012 $
Net loss before accounting change	(10,493)
Increase in finance expense	(38)
Increase in selling and administrative expense	(174)
Decrease in deferred income tax expense	35
Net loss after accounting change	(10,670)

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

Adjustments to comprehensive income	**Three Months Ended March 31, 2012 $**
Comprehensive loss before accounting change	(8,687)
Increase in net loss	(177)
Increase in actuarial gain	204
Increase in cumulative translation adjustment	3
Comprehensive loss after accounting change	(8,657)

New and Revised Standards Adopted with no Material Effect on Statements

During 2011, the International Accounting Standards Board ("IASB") issued a number of new and revised accounting standards which are effective for annual periods beginning on or after January 1, 2013. The following new and revised accounting standards were adopted by the Company effective January 1, 2013 and did not have a material impact on the amounts recorded in the financial statements of the Company:

- IFRS 10 – *Consolidated Financial Statements*;
- IFRS 11 – *Joint Arrangements*;
- IFRS 12 – *Disclosure of Interests in Other Entities*;
- IFRS 13 – *Fair Value Measurement*; and
- IAS 28 (revised) – *Investments in Associates and Joint Ventures*.

Further details of these new or revised accounting standards can be found in the consolidated financial statements and notes as at and for the year ended December 31, 2012.

IFRS 9 – Financial Instruments

In 2011, the IASB also amended IFRS 9 – *Financial Instruments*, which is effective for annual periods beginning on or after January 1, 2015. The Company is still in the process of assessing the full impact of this standard. Further details on this standard can be found in the consolidated financial statements and notes as at and for the year ended December 31, 2012.

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

4. OTHER ACCOUNTS RECEIVABLE

	March 31, 2013 $	December 31, 2012 $
Receivable from lender	4,052	4,052
Investment and other tax credits	531	468
Value added tax	3,314	6,668
Holdbacks receivable	–	6,690
Receivable from supplier	6,161	6,241
Government grant	1,033	1,194
Income tax receivable	1,407	–
Other	2,660	3,090
	19,158	28,403

As at March 31, 2013 and December 31, 2012, a customer dispute existed for product supplied by the Company. The complaint was the result of a faulty input which was provided by a third party supplier of the Company. The amount and likelihood of any dispute settlement with the customer is indeterminable. As a result, the following amounts were recorded during 2011:

	$
Amounts payable to third party supplier	(988)
Inventory on hand provided for	4,313
Accounts receivable provided for	2,904
	6,229
Amount recorded as other receivable	6,229
Net effect to the Company	–

The other receivable balance as at March 31, 2013 is $6,161 (December 31, 2012: $6,241). The difference from the initial amount recorded is made up of foreign exchange translation differences. Subsequent to March 31, 2013, the Company has agreed on payment terms from the supplier to recover this entire amount.

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

5. ASSETS AND LIABILITIES HELD FOR SALE AND DISCONTINUED OPERATIONS

On March 13, 2013, the Company entered into a share purchase agreement with Glatfelter Gernsbach GmbH & Co. KG and its parent, P.H. Glatfelter Co., to sell all of the shares of its wholly owned subsidiary, Dresden Papier GmbH for an aggregate purchase price of EUR 160,000 subject to working capital adjustments. The transaction excludes cash and long-term debt. As at March 31, 2013, the assets and liabilities to be sold have been reclassified as held for sale with the non-current assets being recorded at the lower of the carrying amount or fair value less cost to sell. No impairment was recorded on the reclassification as the fair value less costs to sell exceeded the carrying amount.

At March 31, 2013, the following assets and liabilities are classified as held for sale:

	March 31, 2013 $
Restricted cash	522
Accounts receivable	9,060
Inventories	14,247
Prepaid expenses	139
Property, plant and equipment	29,552
Assets held for sale	53,520
Accounts payable and accrued liabilities	14,903
Income taxes payable	3,182
Deferred income tax liability	395
Liabilities held for sale	18,480

The Dresden mill represents the entire wallpaper segment of the Company. The results for the three months ended March 31, 2013 and the three months ended March 31, 2012 have been reclassified in the statement of operations as discontinued operations. The results of the discontinued operations are as follows:

	Three Months March 31, 2013 $	Three Months March 31, 2012 $
Income before income taxes	9,400	5,319
Income taxes	(2,959)	(1,783)
Net income from discontinued operations	6,441	3,536
Cash flows from operating activities	4,269	5,938
Cash flows from investing activities	(2,161)	(920)
Cash flows from financing activities	17,856	3,290
Increase in cash	19,964	8,308

On April 30, 2013, the sale of the Dresden mill was completed *(Note 13)*.

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

6. PROPERTY, PLANT AND EQUIPMENT

During the three months ended March 31, 2013, the Company sold non-core land at the Landqart mill for $3,583. The carrying amount of the assets sold was $1,723 with a resulting gain on the sale of $1,860.

7. LONG-TERM DEBT

	Note	March 31, 2013 $	December 31, 2012 $
Credit facilities with lenders			
EUR 96, interest at 2.7%, maturing 2013, secured by certain current assets	13	125	126
EUR 21,250, interest at 3.8%, maturing 2017, secured by certain property, plant and equipment	13	27,528	29,305
CHF 1,165, interest at 4.9%, maturing 2015, secured by certain property, plant and equipment		1,250	2,445
CHF 5,310, maturing 2020, unsecured		4,827	4,849
EUR 15,000, floating interest, maturing 2018	13	19,457	–
$104,636, interest up to 5.5%, maturing 2020, secured by certain assets		104,662	104,523
Undrawn credit facility	7(a)	–	–
Unsecured convertible debentures			
$40,250, interest at 6.5%, maturing 2016		34,981	34,695
$25,000, interest at 7%, maturing 2017		22,658	22,548
$69,000, interest at 7%, maturing 2019		57,704	57,410
		273,192	255,901
Less: Current portion		(14,288)	(7,761)
Long-term debt		258,904	248,140

	March 31, 2013 $	December 31, 2012 $
Principal value of debt	293,656	277,165
Unamortized borrowing costs and amounts allocated to equity for convertible debentures	(20,464)	(21,264)
Net amount recorded in liabilities	273,192	255,901

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

Borrowings under the above agreements require maintenance of certain financial and non-financial covenants. The Company has been in compliance with all covenants for all periods presented.

At March 31, 2013, the fair value of the long-term debt, measured at its amortized cost of $273,192, was $258,997. The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

(a) The credit agreement is a facility for up to $132.4 million, granted to Fortress Global Cellulose to support the conversion to dissolving pulp expenditure program and is secured by the assets of Fortress Global Cellulose. The loan is repayable ten years after the first draw on the facility. At March 31, 2013, $nil 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 two years after the first draw on the loan, the facility is repayable in equal quarterly installments. Interest for the first two years of the credit agreement is added to the principal of the loan.

Borrowing costs of $7,006 have been deferred and recorded as a prepaid expense until the loan is drawn upon.

Included in the borrowing costs of the loan are 715,000 warrants which have been provided to the lender. The warrants have an exercise price of $21.52 and are exercisable from December 31, 2014 to December 31, 2017, when they expire *(note 8)*.

8. SHARE CAPITAL

Authorized

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

Issued and fully paid — common shares

	Note	Number of Shares	Share Capital $
Balance, December 31, 2011		14,303,594	175,200
Restricted Share Units vested	9	115,481	2,013
Options exercised	9	76,000	839
Balance, December 31, 2012		14,495,075	178,052
Restricted Share Units vested	9	8,307	166
Deferred Share Units vested	9	4,204	99
Balance, March 31, 2013		14,507,586	178,317

On June 20, 2012 the Company issued 715,000 warrants to a lender. The warrants have an exercise price of $21.52 and are exercisable from December 31, 2014 to December 31, 2017, when they expire. All 715,000 warrants were outstanding as at March 31, 2013.

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

9. 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

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

	Number of options	Weighted Average Exercise Price $
Balance, December 31, 2011	566,725	8.00
Exercised	(76,000)	8.00
Granted	300,000	15.41
Cancellation	(100,000)	8.00
Balance, December 31, 2012	690,725	11.22
Forfeited	(40,000)	15.41
Balance, March 31, 2013	650,725	10.96

During the three months ended March 31, 2013, 40,000 unvested options were forfeited when an employee left the Company.

As at March 31, 2013, 650,725 stock options were exercisable (December 31, 2012: 590,725). The stock options issued have various vesting dates that range from immediately to five years from the grant dates.

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, 2011	142,873	5,642
Granted	6,797	163
Balance, December 31, 2012	149,670	5,805
Granted	11,746	133
Vested	(4,204)	-
Balance, March 31, 2013	157,212	5,938

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, 2011	262,664
Granted	60,869
Vested	(115,481)
Forfeited	(6,850)
Balance, December 31, 2012	201,202
Granted	68,296
Vested	(8,307)
Balance, March 31, 2013	261,191

10. COMMITMENTS

As at March 31, 2013, the Company has committed to purchase $8,200 in property, plant, and equipment.

As at March 31, 2013, the Company has performance bonds in the amounts of EUR 6,384 and CHF 74.

As at March 31, 2013, the Company has committed to purchase steam from a supplier up to the end of 2015 for CHF 900 per year.

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

11. SEGMENTED INFORMATION

The segmentation of the Company's manufacturing operations is based on a number of factors, including production and economic characteristics. Fortress' business segments were re-classified in 2012 given changes in the nature of products being produced. The Landqart mill and Fortress Optical Features produce security papers and products. The Dresden mill produces non-woven wallpaper base products. The entire wallpaper division has been classified as assets and liabilities held for sale and discontinued operations *(Note 5)*. Fortress Specialty Cellulose produces dissolving pulp products. For the three months ended March 31, 2012, the Dissolving Pulp segment operating results up to March 18, 2012 were capitalized to property, plant and equipment during the startup period for dissolving pulp.

	Three months ended March 31, 2013			
	Security $	Pulp $	Corporate $	Continuing Operations $
Sales	28,673	28,886	–	57,559
Operating income (loss)	(4,122)	(11,026)	(3,276)	(18,424)
Amortization[1]	1,985	2,349	–	4,334
Stock-based compensation[1]	–	–	(928)	(928)
Capital expenditures	419	19,889	–	20,308
Total assets	141,878	376,029	15,734	533,641

Sales by geographic area	%
Europe	1.7
Asia	89.3
Other	9.0
Total	100.0

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

	Three months ended March 31, 2013		
	Discontinued Operations (Wallpaper) $	Continuing Operations $	Fortress Paper Consolidated $
Sales	42,102	57,559	99,661
Operating income (loss)	9,789	(18,424)	(8,635)
Amortization[1]	745	4,334	5,079
Stock-based compensation[1]	–	(928)	(928)
Capital expenditures	2,145	20,308	22,453
Total assets	53,520	533,641	587,161

Sales by geographic area	%	%	%
Europe	96.1	1.7	41.6
Asia	3.8	89.3	53.1
Other	0.1	9.0	5.3
Total	100.0	100.0	100.0

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

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

	Three months ended March 31, 2012			
	Security	Pulp	Corporate	Continuing Operations
	$	$	$	$
Sales	13,276	10,435	–	23,711
Operating income (loss)	(7,271)	(4,697)	(2,904)	(14,872)
Amortization[1]	(1,960)	(1,168)	–	(3,128)
Stock-based compensation[1]	–	–	(411)	(411)
Capital expenditures	598	20,478	–	21,076
Total assets	143,385	279,794	3,649	426,828

Sales by geographic area	%
Europe	25.7
Asia	44.0
Other	30.3
Total	100.0

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

	Three months ended March 31, 2012		
	Discontinued Operations (Wallpaper)	Continuing Operations	Fortress Paper Consolidated
	$	$	$
Sales	37,658	23,711	61,369
Operating income (loss)	8,563	(14,872)	(6,309)
Amortization[1]	(869)	(3,128)	(3,997)
Stock-based compensation[1]	–	(411)	(411)
Capital expenditures	1,226	21,076	22,302
Total assets	56,965	426,828	483,793

Sales by geographic area	%	%	%
Europe	97.0	25.7	69.5
Asia	–	44.0	17.0
Other	3.0	30.3	13.5
Total	100.0	100.0	100.0

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

12. SUPPLEMENTARY CASH FLOW INFORMATION

Non-cash items

Non cash property, plant and equipment purchases included in accounts payable increased by $2,702 for the three months ended March 31, 2013 and decreased by $22,674 for the three months ended March 31, 2012.

13. SUBSEQUENT EVENTS

On April 30, 2013, the Dresden mill was sold for EUR 160,000 subject to working capital adjustments. Concurrent with the sale of Dresden, proceeds were utilized to repay EUR 36,376 in outstanding long-term debt.