FORTRESS PAPER LTD
Q1 2014

FOR THE THREE MONTHS ENDED

March 31, 2014

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 12, 2014. The MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements and the notes thereto for the quarter ended March 31, 2014 (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, 2014 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.

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; expectations surrounding and resulting from the final determination in China's Ministry of Commerce anti-dumping investigation, including the Company' response to the final duty; benefits that may accrue to the Company as a result of certain acquisitions, dispositions, capital expenditure programs, equipment upgrades and maintenance shut-downs; expected returns on certain business segments; availability of funds for debt allocation; the expected benefits to be derived from implementing a swing mill strategy at the Fortress Specialty Cellulose mill; 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; the results of a tender for a new power supply agreement; the securement of new purchase orders; 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 realize significant cost-savings from production improvements, cost reduction initiatives and the cogeneration facility at the Fortress Specialty Cellulose mill; that current depressed dissolving pulp prices are indicative of unusual market conditions and are not sustainable in the medium to long term; that the final duty imposed by the Chinese Ministry of Commerce, may result in the supply of dissolving pulp decreasing significantly with a corresponding price increase in the short to medium term; that demand for viscose staple fibre will continue to grow which will result in an increased demand for dissolving pulp; that the swing mill strategy at the Fortress Specialty Cellulose mill will assist in mitigating the adverse impacts resulting from the imposition of the dumping tariff on dissolving pulp exports into China; that the adverse impact of any dumping tariff will be limited to the short-term; that the Company will be able to successfully implement measures that will mitigate the impact of the final duty on dissolving pulp on its business; that the Landqart mill will continue operating on a consistent and regular basis in order to produce and deliver on its banknote orders; that the Landqart mill will secure new orders; the general stability of the economic, political and regulatory environments within the countries where the Company conducts operations; that the Company will be able to enter into enforceable supply agreements for dissolving pulp on favourable terms and diversify its customer base; 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; 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; fluctuations in the market price for products sold; trade restrictions or import duties imposed by foreign governments; that the Company's continuing efforts to reverse the final dissolving pulp dumping duty will be unsuccessful; 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; foreign exchange fluctuations; availability of financing (as necessary); dependence on major customers; and other risk factors detailed in our Annual Information Form dated March 31, 2014 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 (calculated as net loss 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 for Continuing Operations") and adjusted net loss per share (calculated as adjusted net loss divided by the weighted average number of shares outstanding in the period). EBITDA, adjusted net (loss and adjusted net loss per share are not generally accepted earnings measures and should not be considered as an alternative to net 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 (loss and adjusted net loss per share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of EBITDA and adjusted net loss to net 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, 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, 2014, the Company operated internationally in two distinct business segments: the Dissolving Pulp Segment, and the Security Paper Products Segment. The Company previously operated its specialty papers business through 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. Accordingly, references in this MD&A to "discontinued operations" refer to the Specialty Papers Segment.

The Company operates its dissolving pulp business through the Fortress Specialty Cellulose ("FSC") mill located in Thurso, Québec, Canada. The mill expanded into the renewable energy generation sector in October 2013 with the completion of the cogeneration facility. The Company is also evaluating expanding its dissolving pulp capacity by converting the Fortress Global Cellulose ("FGC") mill located at Lebel-sur-Quévillon, Québec into a dissolving pulp mill and re-starting the cogeneration facility. The Company operates its security paper products business through 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.

Overall Performance

EBITDA loss of the Company was $13.6 million for the three months ended March 31, 2014. The Dissolving Pulp Segment generated EBITDA loss of $15.2 million and the Security Paper Products Segment generated EBITDA of $3.2 million. Corporate costs contributed $1.6 million to EBITDA loss. For the three months ended December 31, 2013, EBITDA loss was $9.4 million and for the three months ended March 31, 2013, EBITDA loss from continuing operations was $13.2 million.

Fortress reported adjusted net loss of $25.9 million, or diluted adjusted net loss per share of $1.77 for the first quarter of 2014 on sales of $53.9 million. In the fourth quarter of 2013, the Company reported adjusted net loss of $21.2 million or diluted adjusted net loss per share of $1.46 on sales of $37.2 million, and for the first quarter of 2013, adjusted net loss from continuing operations of $20.6 million or diluted adjusted net loss per share of $1.42 on sales of $57.6 million.

Fortress reported net loss of $23.4 million, or diluted net loss per share of $1.61 for the first quarter of 2014. In the fourth quarter of 2013, the Company reported net loss of $54.7 million or diluted net loss per share of $3.76, and for the first quarter of 2013, net loss from continuing operations of $18.8 million or diluted net loss per share of $1.30. Included in the fourth quarter of 2013 net loss was an impairment of property plant and equipment of $32.9 million relating to the assets of FGC. See "Management's Outlook – Dissolving Pulp Segment" for a further discussion on the FGC mill.

After planned market downtime through to early March 2014, the FSC mill restarted production and continued to realize its swing mill capabilities producing 14,130 air dried metric tonnes (“ADMT”) of northern bleached hardwood kraft (“NBHK”) pulp. The FSC mill sold 8,849 ADMT of dissolving pulp and 11,410 ADMT of NBHK pulp in the first quarter of 2014. Subsequent to March 31, 2014 to-date, the FSC mill has sold approximately 6,000 ADMT of dissolving pulp and 8,700 ADMT of NBHK pulp.

Results from the Dissolving Pulp Segment reflect approximately nine weeks of market downtime during the quarter combined with challenges during the subsequent ramp-up of both the FSC mill and cogeneration plant. In addition, continued delays in negotiations with FSC’s customers due to the impact of the interim duty imposed by China's Ministry of Commerce ("MOFCOM") has resulted in higher logistic and storage costs.

In early March, production began with NBHK pulp and transitioned to dissolving pulp late-April. The Company is encouraged by recent mill results as production efficiencies and cash costs improve.

The Security Paper Products Segment experienced a fifth consecutive quarter with sales, volumes and revenues significantly higher relative to any comparative period in 2012. The Landqart mill continues to implement new initiatives to improve efficiencies and profitability. EBITDA for the Security Paper Products Segment for the quarter ended March 31, 2014 was $0.5 million higher when compared to the fourth quarter of 2013, and $5.3 million higher compared to the first quarter of 2013. However, less than favourable conditions, including the strength of the Swiss franc against the Euro, continue to adversely impact the results of the Security Paper Products Segment. The Landqart mill achieved over 2,500 tonnes of security paper sales in the first quarter of 2014, compared to 2,097 tonnes of security paper sales in the fourth quarter of 2013.

Management's Outlook

Dissolving Pulp Segment

The poor results of the first quarter of 2014 reflect the ten week market downtime at the FSC mill announced in mid-December 2013, and unusually cold temperatures at the mill site which increased heating costs both during the mill's downtime and the subsequent start-up period. The Company also incurred additional logistics costs such as demurrage, customs and storage, resulting from unexpected delays in concluding sales of its dissolving pulp inventory to customers in China.

MOFCOM announced its decision on the final anti-dumping duty for Canadian, American and Brazilian companies on April 4, 2014. The final duty applicable to dissolving pulp produced at the FSC mill remains at 13%. With the final duty and its specifications now established, the Company is working to re-establish a more normalized sales cycle with new and existing customers and focus on continued progress to reduce costs at the mill. The uncertainty surrounding the duty caused significant challenges during negotiations with customers based in China, which lead to a material decrease in sales, sales commitments and cost. The necessary market downtime provided the Company with an opportunity to conclude sales agreements for much of the dissolving pulp inventory previously accumulated. See "*Significant Developments – China Anti-Dumping Investigation*".

The dissolving pulp market has been weakening since the beginning of 2014 due to a low pricing environment for viscose staple fibre ("VSF") caused by recent overcapacity. Management believes that, going forward, dissolving pulp markets may be impacted by the following, among other factors:

- The MOFCOM dumping duty has resulted in some producers moving away from VSF production to produce fluff pulp, which is expected to continue for the short to medium term.

- The MOFCOM duty is expected to cause delays to or abandonment of certain new dissolving pulp projects that have been announced over the past few years, which would impact the supply and demand balance by approximately 2015.

- Certain major international VSF producers have recently announced downtime at their production facilities, which is expected to create more downward pressure on dissolving pulp pricing in the near term.

Management continues to believe that low dissolving pulp prices are not sustainable in the medium to long term and market dynamics will pressure high cost dissolving pulp mills to change product or shut down. Despite current overcapacity, demand for VSF is expected to continue to grow, primarily as a result of medium to long term reductions in cotton supply, such that additional viscose capacity coming on-line in China will get absorbed leading to overall increased demand for dissolving pulp.

The FSC mill initiated restart procedures in early March 2014, initially producing NBHK pulp through late April. The start-up timing was in line with the previously announced shutdown schedule, but ramp-up was much slower than expected due to issues with the waste water treatment plant, which was unable to accept and fully process the biomass load due to cold weather and frozen lines in many areas of the mill. Production has continued to ramp-up and has exceeded expectations following the smooth transition from NBHK pulp to dissolving pulp. The combined effect of improved production as a result of the work done during the downtime, cost reduction initiatives to reduce oil consumption, and stabilized electricity generation, is expected to result in an improved cost structure beginning in the second quarter of 2014.

As management expects the dissolving pulp market to remain depressed in the near term, the focus will remain on cost reduction initiatives to position the mill further down the cost curve and swing production between NBHK pulp and dissolving pulp to capitalize on market opportunities.

In May 2014, the FSC mill was awarded a power supply agreement by Hydro Québec for an additional 5.2MW of power to be produced at the cogeneration facility, which is expected to result in significant incremental cost savings per year. The Company is also evaluating different options to convert the heating of the lime kiln from oil to natural gas which would provide additional significant annual cost savings.

The final duty imposed by MOFCOM on dissolving pulp imports from all other unnamed current or future Canadian dissolving pulp producers, which would include the FGC mill upon conversion to a dissolving pulp producer exporting into China, was reduced to 23.7%. Despite the reduction, such duty materially impacts the economic viability of converting the FGC mill to a dissolving pulp mill. For accounting purposes, the net book value of the FGC assets were impaired to nil in the fourth quarter of 2013 as a result of the MOFCOM interim duty and its uncertainty relating to its final determination. Accordingly, the Company is continuing the process of exploring strategic alternatives for the FGC mill to mitigate the financial risk, including alternative financing structures, joint ventures and partnership opportunities. 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 definitive investment arrangements will be concluded or that the FGC mill project will proceed to completion as previously planned.

Security Paper Products Segment

The Landqart mill currently has a strong order book consisting of a mix of new and repeat orders. In addition, the outlook for further opportunities continues to be positive despite an ongoing competitive market for banknote tenders. Key performance indicators such as waste rates and operational efficiencies have improved throughout the first quarter of 2014. Results reflect the foregoing, combined with an improved product mix. Based on the current order book, it is expected that total 2014 production volumes will be comparable to those in 2013. However, product mix which also has an impact on the financial results of the segment, will vary.

A significant milestone was recently achieved when Durasafe® was confirmed as the substrate of the ninth series of the Swiss Franc by the Swiss National Bank ("SNB") in May 2014. Durasafe® is the innovative new composite paper-polymer-paper banknote substrate developed by the Landqart mill. See "*Significant Developments – Durasafe*".

Significant Developments

Deferral on Investissement Quebec ("IQ") Loan

On March 31, 2014, the Company announced that it had been granted a deferral on its upcoming principal payment under its $102.4 million project financing loan with IQ relating to its FSC mill (the "IQ Loan"). The Company received, without penalty, a deferral of approximately $4.3 million in principal repayment which was payable in the second quarter of 2014. This principal payment deferral is in addition to the previously disclosed deferral of approximately $5.3 million in principal and interest payments which were payable during the first quarter of 2014. The purpose of these deferrals is to provide the Company with greater financial flexibility and increased working capital. The arrangement reflects the Company’s positive ongoing partnership with IQ during this transitory period in the dissolving pulp industry.

China Anti-Dumping Investigation

On April 4, 2014, the Company announced that MOFCOM made its final determination in its anti-dumping investigation on dissolving pulp imports into China. The final duty applicable to dissolving pulp from the FSC mill remained unchanged from the interim duty of 13%. The final duty imposed by MOFCOM on dissolving pulp imports from all other unnamed current or future Canadian dissolving pulp producers, which includes the Company’s FGC mill, was reduced to 23.7%. The Company believes that MOFCOM’s decision may serve to materially harm the business of Chinese VSF producers and continues to believe, as previously submitted to MOFCOM, that the assessment of injury to China’s dissolving pulp market and allegations of ‘dumping’ activities by Canadian producers are unsupported by the facts. Chinese VSF producers have petitioned to MOFCOM against the duty as being harmful to their businesses.

Currently, the Company is evaluating its options in response to the duty including, but not limited to, petitioning the Canadian Government to make an application to the World Trade Organization (“WTO”) to review MOFCOM's determination on the grounds that China's domestic dissolving pulp industry suffered no injury as a result of imported dissolving pulp from the investigated countries. Furthermore, management believes that the manner in which MOFCOM determined FSC's dumping margin was entirely inappropriate and contrary to WTO regulations which govern such investigations. WTO cases typically have a duration of approximately two years, inclusive of appeal process. Although the Company believes it has strong arguments against the imposition of a dumping duty, there is no assurance that it will be successful in reversing MOFCOM's final determination or in securing the Canadian Government's support in commencing a WTO review.

During the fourth quarter of 2013, the Company recorded an impairment in the carrying value of its FGC mill assets as a result of MOFCOM's investigation. Despite the reduction in the duty for the FGC mill, such duty materially impacts the economic viability of converting the FGC mill to a dissolving pulp mill, and therefore the impairment is unaffected. Accordingly, the Company is currently evaluating strategic alternatives for the mill.

As part of its strategy to mitigate the adverse effects of the dissolving pulp duty, during the fourth quarter of 2013, the Company successfully completed testing on the ability to operate the FSC mill as a "swing mill". With minor modifications and no capital expenditure, the FSC mill is capable of swinging production from dissolving pulp to NBHK pulp. As a result of the flexibility from being a “swing mill”, the FSC mill will be able to lower its cost structure accordingly when redirecting production from dissolving pulp to NBHK pulp, which, relative to dissolving pulp, is simpler to produce and has a higher yield derived from the same fibre source. The FSC mill is capable of shifting production between different products to maximize margins in response to changing market conditions, and will achieve a capacity increase of approximately 25% when redirecting production from dissolving pulp to NBHK pulp.

The flexibility derived from the FSC swing mill strategy is expected to allow the Company to partly mitigate the adverse impacts resulting from the duty on dissolving pulp exports into China. However, such expected advantages are subject to market pricing of NBHK pulp compared to dissolving pulp and whether such pricing is sufficient for sustained operations. The Company anticipates that the adverse impact of the dumping tariff will be limited to the short-term as trade patterns realign to effectively nullify any duty, and expects that global dissolving pulp prices should normalize over the long-term. The redesign of the FSC mill allows the Company to focus production on the most profitable pulp markets in the interim. The Company is also in the process of expanding its dissolving pulp sales network outside of China in order to secure the best pricing for its dissolving pulp and further mitigate the impact of the duty imposed by MOFCOM.

Durasafe®

On May 1, 2014, the Company announced that the Durasafe® banknote paper developed by the Landqart mill has been confirmed as the substrate of the ninth series of the Swiss Franc by the SNB. Durasafe® is the innovative new composite paper-polymer-paper banknote substrate developed by the Company's Swiss security paper manufacturer, Landqart AG, in cooperation with the Swiss Federal Institute of Technology (ETH) Zürich. Durasafe® is composed of two cotton paper outer layers with a fully transparent polymer core. The polymer core in Durasafe® adds stability and higher mechanical strength properties to banknotes as well as high security features. The substrate's unique properties allow windows to be formed virtually anywhere on the banknote and can contain a watermark and security fibres as well as traditional security features, including easy-to-recognise banknote paper tactility.

After several years of development the Company is encouraged with this development as the Swiss Franc is widely accepted as having one of the highest standards of banknote security features in the world. This reference contract should enable the Company to further generate interest with state banks around the world.

Selected Quarterly Information

(thousands of dollars, except per share amounts, exchange rates and shares outstanding, unaudited)	Q1 2014	Q4 2013	Q3 2013	Q2 2013
Sales from continuing operations	53,856	37,183	53,160	59,883
Net loss from continuing operations	(23,421)	(54,731)	(13,427)	(20,851)
Net (loss) income [(1)]	(23,421)	(54,731)	(12,436)	134,125
Basic net loss per share from continuing operations	(1.61)	(3.76)	(0.92)	($1.43)
Diluted net loss per share from continuing operations	(1.61)	(3.76)	(0.92)	($1.43)
Basic net (loss) income per share [(1)]	(1.61)	(3.76)	(0.85)	$9.23
Diluted net (loss) income per share[(1)]	(1.61)	(3.76)	(0.85)	$9.23
Weighted average shares outstanding - Basic (thousands)	14,586	14,574	14,561	14,536
Weighted average shares outstanding - Diluted (thousands)	14,586	14,574	14,561	14,536
Average Swiss/Canadian exchange rate[(2)]	1.2358	1.1626	1.1147	1.0862
Average Euro/Canadian exchange rate [(2)]	1.5117	1.4291	1.3759	1.3367
Average US dollar/Canadian exchange rate [(2)]	1.1033	1.0494	1.0386	1.0231

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

(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	58,747	38,257	43,208
Net (loss) income from continuing operations	(18,814)	(9,914)	(24,051)	5,919
Net (loss) income [(1)]	(12,373)	(4,226)	(19,061)	12,289
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 per share[(1)]	($0.85)	($0.29)	($1.32)	$0.82
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	15,032
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

(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. Throughout 2012, production rates improved in the Dissolving Pulp Segment as the ramp-up at the FSC mill continued, albeit at a slower pace than first anticipated and without operating at the intended fully ramped up rate or designed efficiency levels. In the third quarter of 2012, the FSC 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 any quarter up to that date. As such, sales were higher, but continued deterioration in dissolving pulp prices impacted earnings, which overshadowed improved production. The first quarter of 2013 was characterized by production challenges and the lowest realized dissolving pulp prices experienced to date at that time, which contributed to disappointing results from the Dissolving Pulp Segment. Operating results improved in the second quarter of 2013 compared to the prior quarter after the planned ten day maintenance shut-down. Net loss from continuing operations was negatively impacted by a large deferred income tax expense that was accounted for in the second quarter. The third quarter of 2013 was characterized by continued depressed dissolving pulp prices, trial runs of NBHK pulp, and higher inventory levels. Dissolving pulp sales activity was suspended entirely in the fourth quarter of 2013 as a result of the challenges caused by the announcement of the MOFCOM interim duty. As a consequence of the duty, the FGC mill assets were impaired by $32.9 million in addition to a $3.7 million inventory write-down at the FSC mill. The FSC mill produced NBHK pulp for approximately one month in the fourth quarter and initiated market downtime mid-December for approximately ten weeks. The first quarter of 2014 was impacted by the market downtime and a difficult March ramp-up.

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 2012 year for the Security Paper Products Segment, which materially impacted the Company's quarterly results throughout the year. 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 CHF 18 million. An increase in volume sold during 2013 contributed to improving metrics, higher sales and better results for the Security Paper Products Segment. The first quarter of 2013 was impacted by a realized gain of $1.9 million on the sale of non-core assets and included in the fourth quarter of 2013 was a $1.3 million legal provision. The first quarter of 2014 continued with strong volumes and a slightly favourable product mix resulting in improved results.

First Quarter 2014 Earnings Review

Three Months Ended March 31

Overview

Fortress reported an adjusted net loss of $25.9 million, or diluted adjusted net loss per share of $1.77 for the first quarter of 2014 on sales of $53.9 million. In the fourth quarter of 2013, the Company reported an adjusted net loss of $21.2 million or diluted adjusted net loss per share of $1.46 on sales of $37.2 million, and for the first quarter of 2013, an adjusted net loss from continuing operations of $20.6 million or diluted adjusted net loss per share of $1.42 on sales of $57.6 million.

Cost of products sold from continuing operations was $54.9 million for the three months ended March 31, 2014, compared to $38.0 million for the four months ended December 31, 2013. Sales and cost of products sold in the fourth quarter of 2013 were materially lower as a result of the difficulties encountered by the FSC mill from the preliminary duty imposed by MOFCOM. In the first quarter of 2013, cost of products sold was $60.9 million.

Selling, general and administrative ("SG&A") expenses were $12.6 million for the first quarter of 2014, compared to $9.3 million for the fourth quarter of 2013. The prior year comparative period SG&A from continuing operations was $9.8 million. SG&A was significantly higher in the first quarter of 2014 compared to the fourth quarter of 2013, primarily as a result of increased commissions at the Security Papers Products Segment, amounts expensed relating to ongoing maintenance at the FGC mill, uncertainties caused by MOFCOM and a one-time increase in logistic fees for finished goods held offsite pending completion of sales of pulp into China.

Stock-based compensation expense was $0.2 million during the first quarter of 2014, compared to ($0.3) million in the fourth quarter of 2013. The prior year comparative period stock-based compensation expense was $0.9 million. The fourth quarter of 2013 was impacted by a reversal of stock based compensation expense relating to cancellations during the quarter and a change in estimate for certain financial performance based compensation awards.

Selected Financial Information and Statistics

(thousands of dollars, except shipments, unaudited)	**Q1 2014**	**Q4 2013**	**Q1 2013**
Sales from continuing operations	53,856	37,183	57,559
EBITDA from continuing operations[1]	(13,626)	(9,367)	(13,162)
EBITDA[2] [3]	(13,626)	(9,367)	(2,627)
Net loss from continuing operations	(23,421)	(54,731)	(18,814)
Net loss [3]	(23,421)	(54,731)	(12,373)
Adjusted net loss from continuing operations [4]	(25,858)	(21,247)	(20,618)
Paper shipments (tonnes) [5]	2,583	2,097	2,179
Pulp shipments (ADMT)	20,259	6,758	39,147

(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 2014**	**Q4 2013**	**Q1 2013**
Net loss	(23,421)	(54,731)	(18,814)
Foreign exchange (gain) loss	(1,562)	(123)	56
Gain on sale of property, plant and equipment	(875)	-	(1,860)
Impairment of property, plant and equipment	-	32,907	-
Legal provision	-	700	-
Adjusted net loss	(25,858)	(21,247)	(20,618)
Basic and diluted net loss per share	(1.61)	(3.76)	(1.30)
Adjusted net loss per share, basic and diluted	(1.77)	(1.46)	(1.42)

Net Loss to EBITDA Reconciliation for Continuing Operations:

(thousands of dollars, unaudited)	**Q1 2014**	**Q4 2013**	**Q1 2013**
Net loss	(23,421)	(54,731)	(18,814)
Income tax (recovery) expense	(14)	620	(1,815)
Foreign exchange (gain) loss	(1,562)	(123)	56
Net finance expense	5,683	4,698	4,009
Amortization	6,325	6,821	4,334
Gain on sale of property, plant and equipment	(875)	-	(1,860)
Impairment of property, plant and equipment	-	32,907	-
Legal provision	-	700	-
Stock based compensation	238	(259)	928
EBITDA	(13,626)	(9,367)	(13,162)

Net Loss to EBITDA Reconciliation Including Discontinued Operations:

(thousands of dollars, unaudited)	Q1 2014	Q4 2013	Q1 2013
Net loss	(23,421)	(54,731)	(12,373)
Income tax (recovery) expense	(14)	620	1,144
Foreign exchange (gain) loss	(1,562)	(123)	81
Net finance expense	5,683	4,698	4,373
Amortization	6,325	6,821	5,080
Gain on sale of property, plant and equipment	(875)	-	(1,860)
Impairment of property, plant and equipment	-	32,907	-
Legal provision	-	700	-
Stock based compensation	238	(259)	928
EBITDA	(13,626)	(9,367)	(2,627)

Operating Results by Business Segment

Dissolving Pulp Segment

(thousands of dollars, except for shipments, unaudited)	Q1 2014	Q4 2013	Q1 2013
Sales	15,282	7,182	28,886
Operating loss	(19,360)	(15,442)	(11,026)
NBHK Pulp Shipments (ADMT)	11,410	6,758	-
Dissolving Pulp Shipments (ADMT)	8,849	-	39,147

In October 2013, the FSC mill successfully completed the mandatory grid test for its cogeneration facility and was delivering power to the Hydro Québec grid at the contracted commercial rate. The Company expects to derive significant production cost savings as a result. Revenues from the generation of power at the cogeneration facility during the quarter ended March 31, 2014 were negatively impacted by the planned ten week market downtime resulting in $0.1 million in sales revenue compared to $3.0 million in the fourth quarter of 2013.

In October 2013, the FSC mill completed successful testing on its ability to operate as a “swing mill”. The FSC mill is capable of shifting production between dissolving pulp and NBHK pulp to maximize margins in response to changing market conditions.

As at March 31, 2014, the FSC mill held finished goods inventory consisting of 18,716 ADMT of dissolving pulp and 11,240 ADMT of NBHK pulp. At December 31, 2013, the mill held finished goods inventory consisting of 27,565 ADMT of dissolving pulp and 8,520 ADMT of NBHK pulp. The mill did not hold material amounts of dissolving pulp at the end of the prior year comparative period. Inventory levels were high in the fourth quarter of 2013 and subsequently the first quarter of 2014 as a result of sales and shipments during these periods being significantly lower, compared to the prior year comparative periods, a direct effect of the MOFCOM duty and consequent uncertainty created in the marketplace. Subsequent to the quarter ended March 31, 2014, approximately 6,000 ADMT of dissolving pulp and 8,700 ADMT of NBHK pulp inventory were sold.

The FSC mill remained shut down for the first two months of 2014 for market downtime and resumed production of NBHK pulp in early March 2014. The March ramp-up of production and cogeneration was challenging. The combination of market downtime and a difficult ramp-up materially impacted results for the first quarter of 2014. Also, included in the operating loss of the first quarter of 2014 is an inventory fair market valuation allowance of $1.5 million and $2.4 million in duties and additional logistics charges resulting from the MOFCOM investigation and determination.

Security Paper Products Segment

(thousands of dollars, except for shipments, unaudited)	Q1 2014	Q4 2013	Q1 2013
Sales	38,574	30,000	28,673
Operating income (loss)	993	(173)	(4,122)
Shipments (tonnes)	2,583	2,097	2,179

Operating income for the first quarter of 2014 was $1.0 million compared to operating income in the fourth quarter of 2013 of $0.5 million, after excluding legal provision accruals relating to operations from prior years of $0.7 million. The improvement in the quarter is attributable to reduced waste rates and improved efficiencies. Compared to the first quarter of 2013, the first quarter of 2014 reflects higher sales volumes and a better product mix.

Security papers production includes banknotes, which result in varying degrees of costs and margins depending on the complexity of the security features included. Despite the higher sales, less than favourable conditions over the prior years, such as the strength of the Swiss franc against the Euro, continue to adversely impact results.

Fortress Optical Features Ltd. ("Fortress Optical") generated sales of $0.4 million in the first quarter of 2014 compared to $0.2 million in the fourth quarter of 2013. In the first quarter of 2013, $0.5 million of sales revenue were 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 2014	Q4 2013	Q1 2013
Sales	-	-	42,102
Operating income	-	-	9,789
Shipments (tonnes)	-	-	16,008

The Dresden mill was sold on April 30, 2013.

Selected Cash Flow Items

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Cash used by operating activities		
Cash used by operations before working capital changes	(13,604)	(5,612)
Non-cash working capital change	(1,954)	1,628
	(15,558)	(3,984)
Cash used by financing activities	(33)	15,183
Cash used by investing activities		
Additions to property, plant and equipment	(2,123)	(17,727)
Other	(2,128)	4,433
	(4,251)	(13,294)
Change in cash position	(19,842)	(2,095)
Foreign exchange (loss) gain on cash and cash equivalents	1,051	282
Cash and cash equivalents, beginning of year	61,888	31,491
Cash and cash equivalents, end of period	43,097	29,678

Operating Activities

Fortress operates in a cyclical industry and its operating cash flows vary accordingly. Fortress' principal operating cash expenditures are for labour and raw materials. Operating activities used cash of $15.6 million and $4.0 million in the three months ended March 31, 2014 and 2013, respectively. The increase in cash used by operating activities during the three months ended March 31, 2014, was a result of the operating loss in the dissolving pulp segment. Working capital is subject to cyclical operating needs, the timing of collection of receivables and the payment of payables and expenses. The movement in working capital in the first quarter of 2014 was impacted by increased accounts receivable, accounts payable, and increased inventory levels.

Financing Activities

During the first quarter of 2014, financing activities used cash of $0.1 million. The Company deferred $5.3 million in planned principal and interest payments on the IQ Loan that were payable in the quarter ended March 31, 2014. Deferred amounts are amortized and repayable in equal quarterly instalments during the remaining term of the IQ Loan maturing June 30, 2020.

During the first quarter of 2013, financing activities generated $15.2 million. Dresden Papier GmbH ("Dresden"), a subsidiary of Fortress and owner of the Dresden mill which was subsequently sold, had entered into two credit facilities in the aggregate amount of €15 million with Commerzbank AG. The new facilities were 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.

Investing Activities

Investing activities in the first quarter of 2014 used cash of $4.3 million. Investment activities relating to the purchase of equipment and other capital expenditures at the mills was $2.1 million. $2.1 million of restricted cash was added during the first quarter of 2014. Restricted cash relates to cash security provided primarily for banknote contracts in the Security Paper Products Segment.

Investing activities in the first quarter of 2013 used cash of $13.3 million. 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. 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.

Liquidity and Capital Resources

As at March 31, 2014, the Company had cash and cash equivalents balance of $43.1 million. The Company anticipates that approximately $15.5 million in project capital expenditures will be required through to the end of 2015 in order to achieve production efficiency targets and health, safety and environmental objectives.

Although there can be no assurances, Fortress believes that current cash, cash generated from operations, cashflow derived from sale of built-up inventory to normalized levels and proceeds from the divestiture of the Dresden mill and non-core assets, 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 potential renegotiation of existing indebtedness, the financial success of Fortress' business, the successful ability to swing production between dissolving pulp and NBHK pulp at the FSC mill to maximize margins in response to changing market conditions, combined with the cost benefits expected to be derived from the now operational cogeneration facility and other cost savings initiatives, 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, foreign currency exchange rates and the MOFCOM duty. No assurances are given as to the likelihood that the outcome of any such factors will be successful or will operate to positively impact the Company's business, operations and/or financial results.

In addition, Fortress may in the normal course of business advance the amount of duties owing on the importation of dissolving pulp into China. 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.

The Company has entered into a separate project financing loan with IQ of up to $132.4 million to fund the FGC mill conversion project. The Company has not yet drawn any amounts under this loan agreement.

Principal repayments of debt outstanding as at March 31, 2014 are required as follows:

	($ 000's)
2014	9,819
2015	18,926
2016	59,733
2017	44,770
2018	17,942
Thereafter	96,167
	247,357

Under existing credit facilities, the Company has deferred $5.3 million in planned principal and interest payments on the IQ Loan which was payable in the first quarter of 2014, without penalty. The Company has also received, without penalty, an additional deferral of approximately $4.3 million in principal repayment which was payable in the second quarter of 2014. The Company also received non-refundable grants from IQ in the aggregate amount of approximately $0.2 million in the first quarter of 2014 to cover certain costs and expenses relating to the care and maintenance of the FGC mill. The Company received approximately $0.6 million in 2013 for costs incurred from July 2013 to and including November 2013. IQ has agreed to continue to provide such grants through to the end of June 2014.

Commitments

At March 31, 2014, the Company had aggregate indebtedness of $230.7 million and net working capital of $106.3 million.

As at March 31, 2014 the Company has:

- committed to purchase $1.9 million in property, plant, and equipment;
- performance bonds in the amounts of €11.7 million, US$0.2 million and CHF0.1 million; and
- committed to purchase steam from a supplier up to the end of 2015 for CHF0.9 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 continuously monitors the public and private debt markets and the public equity markets in order to ensure 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 net debt and shareholders’ equity as follows:

(thousands of dollars, unaudited)	March 31, 2014 $	December 31, 2013 $
Cash and cash equivalents	43,097	61,888
Less total debt	230,670	228,130
Net debt	(187,573)	(166,242)
Shareholders’ equity	285,011	302,278

The Company has certain financial covenants in its debt obligations stipulating maximum net debt to capitalization 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 period ended March 31, 2014.

Outstanding Shares

The number of common shares outstanding at March 31, 2014 and the date of this report was 14,586,093. The number of options outstanding at March 31, 2014 and the date of this report was 650,725. At March 31, 2014 and the date of this report there were 236,133 and 245,196 restricted share units outstanding, respectively. At March 31, 2014 and the date of this report there were 177,900 and 185,111 deferred share units outstanding, respectively. At March 31, 2014 and the date of this report there were 30,933 performance share units outstanding.

Related Party Transactions

Related party transactions consist of remuneration of directors and other key management personnel with whom we have entered into employment agreements. Further information is contained in our management information circulars in respect of our annual general meetings of shareholders, which are filed 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.

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, 2013, available on SEDAR.

New Accounting Pronouncements

On January 1, 2014, 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 Annual Information Form dated March 31, 2014, 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, 2013, 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, 2014, 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, 2014 $	December 31, 2013 $
ASSETS			
Current			
Cash and cash equivalents		43,097	61,888
Restricted cash		17,761	14,934
Trade accounts receivable		22,845	12,446
Other accounts receivable		10,479	8,751
Inventories		63,262	62,390
Prepaid expenses	6	8,735	8,486
		166,179	168,895
Property, plant and equipment		412,434	412,949
Total assets		578,613	581,844
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities		45,586	34,044
Current portion of long-term debt	6	14,255	14,572
		59,841	48,616
Long-term debt	6	216,415	213,558
Deferred income taxes		4,936	4,734
Provisions and other long term liabilities		8,110	7,921
Employee future benefits		4,300	4,737
Total liabilities		293,602	279,566
Shareholders' equity			
Share capital	7	180,040	180,040
Contributed surplus		26,188	25,950
Retained earnings		52,650	75,368
Accumulated other comprehensive income		26,133	20,920
Total shareholders' equity		285,011	302,278
Total liabilities and shareholders' equity		578,613	581,844

(See accompanying notes)

Approved by the Board of Directors:

“Chadwick Wasilenkoff” — Director

“Anil Wirasekara” — Director

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Canadian dollars, amounts in thousands, unaudited)

	Note	Three Months Ended March 31, 2014 $	Three Months Ended March 31, 2013 $
Sales		53,856	57,559
Costs and expenses			
Manufacturing and product costs		(52,332)	(60,273)
Freight and other distribution costs		(2,521)	(652)
Amortization		(6,325)	(4,334)
Selling, general and administration		(12,629)	(9,796)
Stock-based compensation		(238)	(928)
Operating loss		(20,189)	(18,424)
Other income (expense)			
Finance expense		(5,753)	(4,033)
Finance income		70	24
Gain on sale of property, plant and equipment	5	875	1,860
Foreign exchange gain (loss)		1,562	(56)
Net loss from continuing operations before income taxes		(23,435)	(20,629)
Income tax recovery		14	1,815
Net loss from continuing operations		(23,421)	(18,814)
Net income from discontinued operations	4	–	6,441
Net loss		(23,421)	(12,373)
Loss and diluted loss per share from continuing operations		(1.61)	(1.30)
Loss per share and diluted loss per share		(1.61)	(0.85)
Weighted average number of shares outstanding Basic and diluted		14,586,093	14,501,924

(See accompanying notes)

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

(Canadian dollars, amounts in thousands, unaudited)

	Three Months Ended March 31, 2014 $	Three Months Ended March 31, 2013 $
Net loss	(23,421)	(12,373)
Other comprehensive income (loss)		
Items that may be reclassified subsequently to net income		
Exchange differences on translation of foreign operations	5,213	(881)
	5,213	(881)
Items that will not be reclassified to net income		
Actuarial gain recognized on employee future benefits (net of taxes of ($141) and ($256))	703	1,282
Total other comprehensive income	5,916	401
Total comprehensive loss	(17,505)	(11,972)

(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, 2014 $	Three Months Ended March 31, 2013 $
Share Capital	7		
Balance at beginning of period		180,040	178,052
Restricted share units vested		–	166
Deferred share units vested		–	99
Balance at end of period		180,040	178,317
Contributed Surplus			
Balance at beginning of period		25,950	26,078
Stock based compensation		238	928
Restricted share units vested		–	(166)
Deferred share units vested		–	(99)
Balance at end of period		26,188	26,741
Retained Earnings			
Balance at beginning of period		75,368	23,387
Net loss		(23,421)	(12,373)
Defined benefit plan actuarial gain, net of tax		703	1,282
Balance at end of period		52,650	12,296
Accumulated Other Comprehensive Income			
Balance at beginning of period		20,920	2,152
Cumulative translation adjustment on foreign operations		5,213	(881)
Balance at end of period		26,133	1,271
Total equity		285,011	218,625

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Canadian dollars, amounts in thousands, unaudited)

	Note	March 31, 2014 $	March 31, 2013 $
Cash flows from (used by) operating activities			
Net loss for the period		(23,421)	(12,373)
Adjustments:			
Gain on sale of property, plant and equipment	5	(875)	(1,860)
Amortization	5	6,325	5,080
Income tax expense		(14)	1,144
Income taxes paid		–	(2,827)
Foreign exchange gain		(1,610)	(102)
Finance expense		5,753	4,398
Stock-based compensation		238	928
		(13,604)	(5,612)
Change in non-cash working capital items			
Accounts receivable		(10,664)	(2,195)
Inventories		813	5,617
Prepaid expenses		(1,239)	(917)
Accounts payable and accrued liabilities and other		9,136	(877)
		(15,558)	(3,984)
Cash flows from (used by) financing activities			
Repayment of long-term debt		–	(2,839)
Proceeds from long-term debt		–	19,860
Payment of long-term debt interest		(33)	(1,838)
		(33)	15,183
Cash flows from (used by) investing activities			
Additions to property, plant and equipment		(2,123)	(17,727)
Proceeds from sale of property plant and equipment	5	–	3,583
Restricted cash		(2,128)	850
		(4,251)	(13,294)
Decrease in cash position		(19,842)	(2,095)
Foreign exchange gain on cash and cash equivalents		1,051	282
Cash and cash equivalents, beginning of year		61,888	31,491
Cash and cash equivalents, end of period		43,097	29,678

(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. Fortress operates internationally in two distinct business segments: dissolving pulp and security paper products. The Company operates its dissolving pulp business at the Fortress Specialty Cellulose Mill located in Canada. As of September of 2013, the Fortress Specialty Cellulose Mill also operates in the renewable energy sector with the completion of a cogeneration facility. The Company is also evaluating expanding its dissolving pulp capacity by converting the Fortress Global Cellulose Mill located at Lebel-sur-Quévillon, Québec into a dissolving pulp mill and re-starting the cogeneration facility. Up to April 30, 2013, the Company operated its specialty papers business at the Dresden Mill located in Germany, where it was a producer of specialty non-woven wallpaper base products. 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 manufactures 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 Board of Directors approved these statements on May 8, 2014.

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, 2013 (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, 2013 consolidated financial statements, with the exception of the changes noted in Note 3 below.

3. NEW ACCOUNTING PRONOUNCEMENTS

Changes in accounting policies

IFRIC 21 – Levies

In May 2013, the IASB issued IFRIC 21 Levies (“IFRIC 21”). IFRIC 21 provides guidance on when an obligating event occurs that gives rise to a liability to pay a government levy that is not income tax. IFRIC 21 is effective for annual periods beginning on or after January 1, 2014. The adoption of this standard did not have a significant impact on the Company’s financial statements.

IFRS 9 – Financial Instruments

The first part of IFRS 9 was issued in November 2009 and addresses classification and measurement of financial assets. IFRS 9 has two measurement categories for financial assets: amortized cost and fair value. All equity instruments are measured at fair value. A debt instrument is at amortized cost only if the entity is holding it to collect contractual cash flows and the cash flows represent principal and interest. Otherwise it is at fair value through profit or loss.

IFRS 9 was amended in October 2010 to include guidance on financial liabilities and derecognition of financial instruments.

IFRS 9 was amended in November 2013, to (i) include guidance on hedge accounting, (ii) allow entities to early adopt the requirement to recognize changes in fair value attributable to changes in an entity's own credit risk, from financial liabilities designated under the fair value option, in OCI (without having to adopt the remainder of IFRS 9) and (iii) remove the previous mandatory effective date of January 1, 2015, although the standard is available for early adoption. The adoption of this standard is not expected to have a significant impact on the Company's financial statements.

4. DISPOSAL OF BUSINESS

On April 30, 2013, the Company sold all of the shares of its wholly owned subsidiary, Dresden Papier GmbH (the "Dresden Mill"), which represented the entire specialty papers segment of the Company, for an aggregate purchase price of EUR 160,000 subject to working capital and other adjustments. The transaction excluded cash and long-term debt associated with the Dresden Mill. Prior to the sale, the long term debt associated with Dresden was repaid by the Company and the factored accounts receivable of the Dresden Mill were repurchased. An early prepayment penalty of $1,166 was recorded on the retirement of the Dresden Mill long term debt.

Based on the book values of the net assets disposed of, the related sales proceeds, and the effect of foreign exchange, the gain on disposal of Dresden Mill is $154,265, as summarized below. The final purchase price adjustment related to income taxes is still being negotiated and is currently based on management's best estimate, which could be subject to change in the future.

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

	April 30, 2013 $
Net assets disposed of	51,090
Sale proceeds:	
Cash	212,240
Less: purchase price adjustments	(1,649)
Less: directly attributable costs	(2,416)
Total net proceeds	208,175
Profit on disposal before recycling of cumulative translation adjustment	157,085
Cumulative translation adjustment	(2,820)
Gain on disposal	154,265

The Dresden Mill represents the entire wallpaper segment of the Company. The results for the three months ended March 31, 2013 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 $
Income before income taxes and gain on disposal	9,400
Income taxes	(2,959)
Net income from discontinued operations	6,441
Cash flows from operating activities	4,269
Cash flows from financing activities	17,856
Cash flows from investing activities	(2,161)
Increase in cash	19,964

5. PROPERTY, PLANT AND EQUIPMENT

During the three months ended March 31, 2014, the Company sold non-core assets at Fortress Global Cellulose Mill for $875. The carrying amount of the assets sold was $nil with a resulting gain on the sale of $875. 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.

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

6. LONG-TERM DEBT

	Note	March 31, 2014 $	December 31, 2013 $
Credit facilities with lenders			
CHF 5,310, maturing 2020, unsecured		5,880	5,549
$105,167, interest up to 5.5%, maturing 2020, secured by the assets of the Fortress Specialty Cellulose Mill	6(a)	106,554	105,107
Undrawn credit facility	6(b)	–	–
Unsecured convertible debentures			
$40,250 principal, interest at 6.5%, maturing 2016		36,191	35,872
$25,000 principal, interest at 7%, maturing 2017		23,118	22,997
$69,000 principal, interest at 7%, maturing 2019		58,927	58,605
		230,670	228,130
Less: Current portion		(14,255)	(14,572)
Long-term debt		216,415	213,558

	March 31, 2014 $	December 31, 2013 $
Principal value of debt	247,357	247,061
Unamortized borrowing costs and amounts allocated to equity for convertible debentures	(16,687)	(18,931)
Net amount recorded in liabilities	230,670	228,130

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, 2014, the fair value of the long-term debt, measured at its amortized cost of $230,670 was $185,147. The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

(a) The lender has agreed with the Company to defer $5,308 in planned principal and interest for the three months ended March 31, 2014, and $4,259 for the three months ended June 30, 2014, without penalty. The facility is due in equal quarterly instalments up to June 30, 2020.

(b) The credit agreement is a facility for up to $132,400, granted to Fortress Global Cellulose to support the conversion to a dissolving pulp mill 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, 2014, $nil has been drawn on this facility. Borrowing costs of $5,338 have been deferred and recorded as a prepaid expense until the loan is drawn upon.

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

7. 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, 2012		14,495,075	178,052
Restricted Share Units vested	8	66,570	1,619
Options exercised	8	24,448	369
Balance, December 31, 2013		14,586,093	180,040
Restricted Share Units vested	8	–	–
Deferred Share Units vested	8	–	–
Balance, March 31, 2014		14,586,093	180,040

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, 2014.

8. STOCK-BASED COMPENSATION

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, 2012	149,670	5,805
Granted	34,990	290
Vested	(24,448)	–
Balance, December 31, 2013	160,212	6,095
Granted	17,688	72
Balance, March 31, 2014	177,900	6,167

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, 2012	201,202
Granted	97,183
Vested	(66,570)
Forfeited	(11,209)
Balance, December 31, 2013	220,606
Granted	62,392
Cancelled	(15,932)
Balance, March 31, 2014	267,066

9. COMMITMENTS

As at March 31, 2014, the Company has committed to purchase $1.9 million in property, plant, and equipment.

As at March 31, 2014, the Company has performance bonds in the amounts of EUR 11,748, USD 170 and CHF 51.

As at March 31, 2014, 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)

10. SEGMENTED INFORMATION

The segmentation of the Company's manufacturing operations is based on a number of factors, including production and economic characteristics. The Landqart mill and Fortress Optical Features produce security papers and products. The Dresden mill produced non-woven wallpaper base products up to April 30, 2013. Fortress Specialty Cellulose produces dissolving pulp products.

	Three months ended March 31, 2014			
	Security $	Pulp $	Corporate $	Fortress Paper Consolidated $
Sales	38,574	15,282	–	53,856
Operating income (loss)	993	(19,360)	(1,822)	(20,189)
Amortization[1]	(2,221)	(4,104)	–	(6,325)
Stock-based compensation[1]	–	–	(238)	(238)
Capital expenditures	200	1,268	–	1,468
Total assets	153,432	382,966	42,215	578,613

Sales by geographic area	%
Europe	4.4
Asia	57.1
Other	38.5
Total	100.0

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

	Three months ended March 31, 2013					
	Security $	Pulp $	Corporate $	Continuing Operations $	Discontinued Operations (Wallpaper) $	Fortress Paper Consolidated $
Sales	28,673	28,886	–	57,559	42,102	99,661
Operating income (loss)	(4,122)	(11,026)	(3,276)	(18,424)	9,789	(8,635)
Amortization[1]	1,985	2,349	–	4,334	745	5,079
Stock-based compensation[1]	–	–	(928)	(928)	–	(928)
Capital expenditures	419	19,889	–	20,308	2,145	22,453
Total assets	141,878	376,029	15,734	533,641	53,520	587,161

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

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

11. SUBSEQUENT EVENT

On April 4, 2014, the Company announced that the Chinese Ministry of Commerce ("MOFCOM") made its final determination in its anti-dumping investigation on dissolving pulp imports into China. The final duty applicable to dissolving pulp from the Fortress Specialty Cellulose Mill remained unchanged from the interim duty of 13%. The final duty imposed by MOFCOM on dissolving pulp imports from all other unnamed current or future Canadian dissolving pulp producers, which includes the Company's Fortress Global Cellulose Mill, was reduced to 23.7%. The final determination does not have an impact on any estimates or balances in the financial statements of the Company as at March 31, 2014 and December 31, 2013.