FORTRESS PAPER LTD.

Q2 2011

FOR THE THREE AND SIX MONTHS ENDED

JUNE 30, 2011

FORTRESS PAPER LTD.
MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations of Fortress Paper Ltd. ("Fortress" or the "Company") has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the company has commenced reporting on this basis and this MD&A should be read in conjunction with the unaudited consolidated financial statements and the notes thereto for the six month period ended June 30, 2011 (available on SEDAR at www.sedar.com). The MD&A provides a review of the significant developments that have impacted the Company's performance during the quarter ended June 30, 2011 relative to the previous quarter and prior year comparative quarter.

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

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

The information in this report is as at August 3, 2011.

Description of Business

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

Highlights

Fortress reported 2011 second quarter EBITDA of $4.6 million. For the three months ended June 30, 2010 EBITDA was $8.3 million and for the first quarter of 2011 EBITDA was $1.0 million.

Fortress reported adjusted net loss of $1.0 million for the second quarter of 2011 on sales of $89.9 million or diluted adjusted loss per share of $0.07. For the second quarter of 2010 the Company reported adjusted net income of $4.5 million or diluted adjusted earnings per share of $0.39 on sales of $60.5 million. In the first quarter of 2011 the Company reported adjusted net loss of $5.6 million on sales of $85.5 million or diluted adjusted loss per share of $0.42.

The Pulp Segment produced specialty NBHK throughout the quarter which resulted in higher cost per tonne, but also a significantly higher price than what would have been achieved in the NBHK market. As previously disclosed, the shut-down of the mill for conversion to dissolving pulp is scheduled for late third quarter 2011. Dissolving pulp sales are anticipated to provide significantly higher margins than NBHK sales.

The Wallpaper Segment produced another strong quarter which was comparable to the record first quarter result. Sales were strong throughout the quarter and margins remained stable.

The challenges experienced by the Security and Specialty Paper Segment in the first quarter continued in the second quarter. High raw material prices, a strong Swiss currency and low utilization have contributed to another challenging quarter. Postponements of several major new currency launches will continue to have an influence on industry over-capacity until released.

Management's Outlook

The positive results from our Pulp Segment reflect the innovation of our team to tailor a unique specialty product which enabled us to realize significantly higher pricing and a margin that could not have been attained producing traditional NBHK. Not only did this provide improved results, but through the extensive development and training that occurred to achieve the tolerances required for this new specialty grade of pulp we are better prepared for the coming transition to dissolving pulp production.

The non-woven wallpaper base segment nearly equaled its record first quarter performance. Margins remain strong and the order log is healthy. We will complete an additional upgrade to our facility during our annual August maintenance shutdown. This will add approximately 10% additional capacity which is expected to have a positive impact starting in the third quarter of 2011. The waste recycling plant continues to increase the overall efficiency of the mill allowing us to further improve our competitive position.

The security and specialty paper segment experienced another challenging quarter. The newly converted PM1 high security paper-machine is performing to specifications; however, similar to the first quarter of 2011, the Landqart mill second quarter 2011 results were impacted by high raw material costs and over capacity due in part to the postponement of implementation of several major currencies. In addition, the strong Swiss currency continues to have a negative impact on the operational cost structure of the mill. As previously reported, the mill has consolidated production of banknote and security papers into PM1 and has temporarily suspended the commercial operation of the smaller PM2 which will be utilized for trials and sample production until such time as this additional capacity is required.

Second Quarter 2011 Earnings Review

Three Months Ended June 30, 2011

Overview

Fortress reported 2011 second quarter EBITDA of $4.6 million. For the three months ended June 30, 2010, EBITDA was $8.3 million and for the first quarter of 2011 EBITDA was $1.0 million.

Fortress reported adjusted net loss of $1.0 million for the second quarter of 2011 on sales of $89.9 million or diluted adjusted loss per share of $0.07. For the second quarter of 2010 the Company reported adjusted net income of $4.5 million or diluted adjusted earnings per share of $0.39 on sales of $60.5 million. In the first quarter of 2011 the Company reported adjusted net loss of $5.6 million on sales of $85.5 million or diluted adjusted loss per share of $0.42

Analysis of Specific Items Affecting Comparability of Net Income

(thousands of dollars, except per share figures, unaudited)	**Q2 2011**	**Q1 2011**	**Q2 2010**
Net income (loss) as reported	2,907	(5,727)	41,816
Foreign exchange (gain) loss	(3,889)	122	1,134
Fair value gain on acquisition	-	-	(41,804)
Start-up costs associated with Fortress Specialty Cellulose mill	-	-	3,368
Adjusted net (loss) income	(982)	(5,605)	4,514
Diluted net income (loss) per share	0.19	(0.43)	3.65
Diluted adjusted (loss) net income per share	(0.07)	(0.42)	0.39

Cost of products sold were $76.1 million or 84.6% of sales for the three months ended June 30, 2011 compared to $75.3 million or 88.0% in the first quarter of 2011. In the second quarter of 2010, cost of products sold were $50.1 million or 82.8% of sales. Included in cost of sales for the second quarter of 2010 are $3.4 million in start-up costs associated with the Fortress Specialty Cellulose mill. Excluding these amounts cost of products sold were 77.2% of sales.

Selling, general and administrative expenses were $9.2 million for the second quarter of 2011 (second quarter 2010, $5.4 million and first quarter 2011, $9.3 million). The prior year comparative period does not reflect a full quarter of selling, general and administrative expenses from the pulp segment as the Fortress Specialty Cellulose mill was acquired April 30, 2010.

Stock-based compensation expense was $0.6 million during the period ($0.7 million and $0.5 million in the second quarter of 2010 and the first quarter of 2011, respectively).

Selected Financial Information and Statistics

(thousands of dollars, except per unit amounts and shipments, unaudited)	Q2 2011	Q1 2011	Q2 2010
Sales	89,906	85,488	60,544
EBITDA[1]	4,601	951	8,334
Operating income (loss)	619	(3,100)	2,374
Net income (loss)	2,907	(5,727)	41,816
Adjusted net (loss) income	(982)	(5,605)	4,514
Paper Shipments (tonnes)	14,670	15,468	16,324
Pulp Shipments (tonnes)	54,384	56,361	18,848

[1]See net income to EBITDA reconciliation.

Net income to EBITDA reconciliation:

(thousands of dollars, unaudited)	Q2 2011	Q1 2011	Q2 2010
Net income (loss)	2,907	(5,727)	41,816
Income tax expense	740	1,536	1,013
Foreign exchange (gain) loss	(3,889)	122	1,134
Net interest expense	861	969	215
Fair value gain on acquisition	-	-	(41,804)
Start-up costs associated with Fortress Specialty Cellulose	-	-	3,368
Amortization	3,394	3,508	1,921
Stock based compensation	588	543	671
EBITDA	4,601	951	8,334

Operating Results by Business Segment

Pulp

(thousands of dollars, except for shipments, unaudited)	Q2 2011	Q1 2011	Q2 2010
Sales	39,961	35,586	13,543
Operating income (loss)	3,316	(940)	(1,124)
Shipments (tonnes)	54,384	56,361	18,848

A full quarter of production of specialty pulp has resulted in higher realized pricing per tonne, an improved margin and a yield reduction relative to the prior quarter. In the prior year comparative period, shipments and results reflect approximately one month of sales as the Fortress Specialty Cellulose mill ramped up production in late May after having been idle for some time. The mill in Thurso was purchased April 30, 2010. The shut-down of the mill for conversion to dissolving pulp is scheduled for late third quarter 2011.

Wallpaper Base Papers Segment

(thousands of dollars, except for shipments, unaudited)	Q2 2011	Q1 2011	Q2 2010
Sales	36,566	37,001	28,930
Operating income	6,804	7,006	3,874
Shipments (tonnes)	13,357	13,981	12,152

Tonnes shipped in the second quarter of 2011 were comparable, but slightly lower than the previous quarter and significantly higher relative to the prior year comparative period due to the capital programs to increase capacity. Margins improved relative to the prior year comparative quarter and remained stable compared to the first quarter of 2011. This is a result of lower costs associated with decreased NBHK pulp prices and higher sales prices realized in the current and previous quarters relative to the second quarter of 2010. The order book at the Dresden mill remains strong.

Security and Specialty Papers Segment

(thousands of dollars, except for shipments, unaudited)	Q2 2011	Q1 2011	Q2 2010
Sales	13,379	12,901	18,070
Operating loss	(6,779)	(6,643)	83
Shipments (tonnes)	1,313	1,487	4,172

Effective October 31, 2010 the last of the specialty papers were produced at the Landqart mill. Shipments in the second quarter of 2011 consisted only of security papers. In the previous quarter shipments consisted of security papers and 514 tonnes of non-woven simplex wallpaper. In the prior year comparative period specialty paper sales were largely influenced by non-woven simplex wallpaper base representing 1,473 tonnes of the shipments. Specialty papers are no longer produced at Landqart as the mill has fully converted to a security paper producer.

Results reflect continued headwinds of a strong CHF, high raw material costs, and over capacity resulting in part from delays in several major new currency launches. As previously indicated, Landqart is taking measures to improve efficiencies as the mill transitions to a higher capacity bank note and other security paper producer.

Fortress Optical Features began operations in the first quarter of 2011 generating sales of $0.3 million and $0.9 million in the second quarter and first quarter of 2011, respectively. Fortress Optical Features produces security material for the security threads used in banknotes.

Six Months Ended June 30, 2011

Analysis of Specific Items Affecting Comparability of Net Income

(thousands of dollars, except per share figures, unaudited)	**June 30, 2011**	**June 30, 2010**
Net (loss) income as reported	(2,822)	41,416
Foreign exchange (gain) loss	(3,767)	3,207
Fair value gain on acquisition	-	(41,804)
Start-up costs associated with Fortress Specialty Cellulose mill	-	3,368
Adjusted net income	(6,589)	6,187
Net (loss) income per share (EPS), as reported	(0.20)	4.05
Net (loss) income per share (EPS) diluted, as reported	(0.20)	3.73
Adjusted (loss) net income per share	(0.48)	0.60
Adjusted (loss) net income per share diluted	(0.48)	0.56

Selected Financial Information and Statistics for the Six Months Ended:

(thousands of dollars, except for shipments, unaudited)	**June 30, 2011**	**June 30, 2010**
Sales	175,394	110,848
EBITDA[1]	5,550	13,437
Operating (loss) income	(2,483)	5,803
Net (loss) income	(2,822)	41,416
Adjusted net (loss) income	(6,589)	6,187
Paper Shipments (tonnes)	30,138	32,710
Pulp Shipments (tonnes)	110,745	18,848

[1]See net income to EBITDA reconciliation.

Net income to EBITDA reconciliation:

(thousands of dollars, unaudited)	**June 30, 2011**	**June 30, 2010**
Net income	(2,822)	$41,416
Income tax	2,276	2,534
Foreign exchange (gain) loss	(3,767)	3,207
Fair value gain on purchase	-	(41,804)
Start-up costs	-	3,368
Interest expense	1,830	450
Amortization	6,902	3,293
Stock based compensation	1,131	973
EBITDA	5,550	13,437

Overview

EBITDA for the Company was $5.6 million for the six months ended June 30, 2011 compared to $13.4 million in the six months ended June 30, 2010. The best six month results for the Dresden mill on record were offset by the challenges experienced by the Landqart mill. In the pulp segment, the Fortress Specialty Cellulose mill continues its efforts to maximize returns producing a specialty NBHK, product prior to the conversion to the higher margin dissolving pulp production.

Total paper product shipments were lower compared to the prior comparative period due to the conversion of the Landqart mill to security papers where in the prior year much of the tonnage was the result of specialty paper production. Somewhat offsetting the decrease in tonnes shipped from Landqart was increased sales and capacity at the Dresden mill.

Total NBHK pulp and specialty pulp shipments reflect a full six months of sales from Fortress Specialty Cellulose mill in 2011, compared to approximately one month of sales as the mill ramped up production in late May after having been idle for some time. The mill in Thurso was purchased April 30, 2010.

In early January 2011, Fortress completed the acquisition of the assets of the Bank of Canada's Optical Security Material (OSM) division (the "OSM Assets"), which produces the optically variable material for the security threads contained in various banknotes, including application in the Canadian banknotes. The Company paid a purchase price of $0.75 million for the OSM assets and granted the Bank of Canada a royalty-free license to use the intellectual property sold to the Company for Canadian banknote applications. The assets are being relocated to a high security production and research facility which the Company is building adjacent to its Fortress Specialty Cellulose mill in Quebec.

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

Also in the six month period ended June 30, 2011, Fortress' wholly-owned subsidiary Dresden Papier GmbH ("Dresden") increased the current credit facility amounting to EUR18.5 million to EUR 22.15 million for the rebuild of Landqart's PM1 into a banknote paper-machine.

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

Operating Results by Business Segment

Pulp Segment

(thousands of dollars, except for shipments, unaudited)	June 30, 2011	June 30, 2010
Sales	75,547	13,543
Operating income (loss)	2,374	(1,124)
Operating income adjusted for start-up costs	-	2,244
Shipments (tonnes)	110,745	18,848

Results in the prior year six month period reflect production from the Fortress Specialty Cellulose mill beginning in late May. Current period results reflect efforts made to produce specialized NBHK to maximize returns while preparing employees for conversion to dissolving pulp.

Security and Specialty Papers Segment

(thousands of dollars, except for shipments, unaudited)	June 30, 2011	June 30, 2010
Sales	26,280	37,181
Operating (loss) income	(13,422)	246
Shipments (tonnes)	2,800	8,459

Product mix, high raw material prices, pricing pressure, a strong Swiss currency and low utilization have contributed to a difficult first six months. As stated previously, postponements of several major new currency launches will continue to have an influence on industry over-capacity until launched. The final sale of specialty paper in the first six months of 2011 was 514 tonnes of simplex non-woven wallpaper base that was sold from inventory as the Landqart mill has been fully converted to a security paper producer. In the prior year comparative period, sales reflect security and specialty papers of which 3,054 tonnes were of simplex non-woven wallpaper base.

Fortress Optical Features began operations in the first quarter of 2011 and generated sales of $1.2 million in the first six months of 2011 and contributed slightly to the operating loss.

Wallpaper Base Papers Segment

(thousands of dollars, except for shipments, unaudited)	June 30, 2011	June 30, 2010
Sales	73,567	60,124
Operating income	13,810	9,579
Shipments (tonnes)	27,338	24,251

Tonnes shipped in the first 6 months of 2011 were 13% higher than the comparable prior year period due to the capital programs to increase capacity. Pricing and margins also improved relative to the prior year comparative quarter as overall raw material prices have receded.

Liquidity and Capital Resources

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

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

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

As at June 30, 2011 and the date of this report, approximately $57 million and $67.5 million, respectively, has been spent for the conversion of Fortress Specialty Cellulose mill from an NBHK producer to a high quality specialty cellulose mill and to construct a new co-generation facility. The Company has reviewed and evaluated capital expenditure to be incurred in year 2012 relating to the construction of the co-generation facility using new equipment instead of refurbished equipment resulting in an estimated total combined project cost of $173 million to $178 million. Project financing of $102.4 million from Investissement Quebec, current cash, federal credits, cash from operations, and the public offering in February 2011 are expected to provide sufficient resources for completion.

At June 30, 2011, the Company had cash of $37.8 million and debt of $61.1 million. Included in this debt is $15.9 million drawn of the approximately $102.4 million facility with Investissement Quebec previously referenced. As at the date of this report a further $15 million of this facility has been drawn.

Operating Activities

Selected Cash Flow Items

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Cash provided before working capital changes	2,930	8,475
Non-cash working capital change	(14,500)	(12,731)
Cash provided from (used by) operating activities	(11,570)	(4,256)
Net proceeds on common share issuance including option exercises	55,421	-
Net proceeds from debt	13,009	24,093
Cash provided from financing activities	68,430	24,093
Cash provided from (used by) investing activities	(60,770)	(24,212)
Change in cash position	(3,910)	(4,375)
Foreign exchange (loss) gain on cash and cash equivalents	(894)	(3,120)

Fortress operates in a cyclical industry and its operating cash flows vary accordingly. Fortress' principal operating cash expenditures are for compensation, fibre, and chemicals. Operating activities used cash of $11.6 million in the six months ended June 30, 2011 compared to $4.3 in the first six months of 2010.

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

Financing Activities

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

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

Also in the six months of 2011, proceeds from debt was $20.5 million, primarily for the conversion project ongoing at Fortress Specialty. Payments on debt and debt interest used cash of $6.3 million and $1.2 million, respectively.

In the first six months of 2010, financing activities generated $24.1 million related to loan proceeds of $26.0 million, debt repayment of $1.6 million and finance expenses paid of $0.4 million.

Investing Activities

Investing activities in the first six months of 2011 and 2010 used cash of $60.8 million and $24.2 million, respectively. Investment activities relate primarily to the purchase of plant and equipment at the mills.

Outstanding Shares

The number of common shares outstanding at June 30, 2011 and the date of this report was 14,242,856. The number of options outstanding at June 30, 2011 and the date of this report was 574,925. At June 30, 2011 and the date of this report there were 315,202 restricted share units. At June 30, 2011 and the date of this report there were 141,580 and 142,264 deferred share units outstanding, respectively.

Critical Accounting Estimates

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

Changes in Accounting Policies

Transition to and Initial Adoption of International Financial Reporting Standards

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

Impact of Adopting IFRS on the Company's Business

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

New Accounting Pronouncements

In the first half of 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, with early adoption permitted. These standards include the following:

- IFRS 9, Financial Statements;
- IFRS 10, Consolidated Financial Statements,
- IFRS 11, Joint Arrangements,
- IFRS 12, Disclosure of Interests in Other Entities; and,
- IFRS 13, Fair Value Measurement,

- IAS 19, Employee Future Benefits

These new and revised accounting standards have not yet been adopted by Fortress, and the Company has not yet completed the process of assessing the impact that they will have on its financial statements or whether to early adopt any of the new requirements.

Disclosure Controls and Internal Controls over Financial Reporting

During the quarter ending June 30, 2011, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

Risks and Uncertainties

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

Selected Quarterly Information

	International Financial Reporting Standards (IFRS)			
(thousands of dollars, except per unit amounts, earnings per share ("EPS"), exchange rates and shares outstanding, unaudited)	**Q2 2011**	**Q1 2011**	**Q4 2010**	**Q3 2010**
Sales	89,906	85,488	83,467	86,971
Operating (loss) income	619	(3,100)	(10,399)	5,931
EBITDA	4,601	951	3,647	8,800
Net income	2,907	(5,727)	(12,790)	5,233
Basic EPS	$0.20	($0.43)	($1.01)	$0.44
Diluted EPS	$0.19	($0.43)	($1.01)	$0.39
Weighted average shares outstanding Basic (thousands)	14,232	13,417	12,626	12,003
Weighted average shares outstanding Diluted (thousands)	15,145	13,417	12,626	13,482
Average Swiss/Canadian exchange rate(1)	1.1147	1.0476	1.0397	1.0085
Average Euro/Canadian exchange rate (1)	1.3937	1.3497	1.3760	1.3438

	IFRS		Previous Canadian GAAP	
(thousands of dollars, except per unit amounts, earnings per share ("EPS"), exchange rates and shares outstanding, unaudited)	**Q2 2010**	**Q1 2010**	**Q4 2009**	**Q3 2009**
Sales	60,544	50,304	51,049	51,000
Operating income	2,374	3,430	6,292	5,198
EBITDA	8,334	5,105	7,885	6,967
Net income	41,816	(397)	3,720	3,467
Basic EPS	$4.08	($0.04)	$0.36	$0.34
Diluted EPS	$3.65	($0.04)	$0.35	$0.34
Weighted average shares outstanding Basic (thousands)	10,237	10,234	10,234	10,234
Weighted average shares outstanding Diluted (thousands)	11,450	10,234	10,487	10,296
Average Swiss/Canadian exchange rate(1)	0.9278	0.9832	1.0341	1.0335
Average Euro/Canadian exchange rate (1)	1.3057	1.4381	1.5600	1.5699

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

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

	June 30, 2011 $	December 31, 2010 $	January 1, 2010 $
ASSETS			
Current			
Cash and cash equivalents	37,755	42,559	33,205
Trade accounts receivable	26,562	10,616	18,034
Other accounts receivable	13,967	16,099	2,614
Inventories	48,076	41,164	26,064
Prepaid expenses	2,253	1,755	873
	128,613	112,193	80,790
Restricted cash	2,564	1,362	45
Property, plant and equipment	254,135	186,774	66,861
Employee future benefits	2,047	1,768	809
Total assets	387,359	302,097	148,505
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities	51,345	38,878	22,447
Income taxes payable	859	3,503	4,446
Current portion of long-term debt *(note 7)*	8,608	8,977	5,378
	60,812	51,358	32,271
Long-term debt *(note 7)*	52,498	41,242	18,039
Deferred income taxes	17,309	18,526	3,227
Provisions	747	185	–
Total liabilities	131,366	111,311	53,537
Shareholders' equity			
Share capital *(note 8)*	174,806	111,148	59,083
Contributed surplus	9,845	10,536	3,198
Accumulated other comprehensive income	7,016	1,909	–
Retained earnings	64,326	67,193	32,687
Total shareholders' equity	255,993	190,786	94,968
Total liabilities and shareholders' equity	387,359	302,097	148,505

(See accompanying notes)

Approved by the Board of Directors:

"Chadwick Wasilenkoff" — Director

"Richard Whittall" — Director

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Canadian dollars, amounts in thousands, unaudited)

	Three Months Ended June 30, 2011 $	Three Months Ended June 30, 2010 $	Six Months Ended June 30, 2011 $	Six Months Ended June 30, 2010 $
Sales	89,906	60,544	175,394	110,848
Costs and expenses				
Cost of products sold	(76,076)	(50,130)	(151,336)	(88,830)
Amortization	(3,394)	(1,921)	(6,902)	(3,293)
Selling, general and administration	(9,229)	(5,448)	(18,508)	(11,949)
Stock-based compensation	(588)	(671)	(1,131)	(973)
Operating income (loss)	619	2,374	(2,483)	5,803
Other income (expense)				
Finance expense	(974)	(230)	(2,063)	(483)
Finance income	113	15	233	33
Fair value gain on acquisition *(note 5)*	–	41,804	–	41,804
Foreign exchange gain (loss)	3,889	(1,134)	3,767	(3,207)
Net income (loss) before income taxes	3,647	42,829	(546)	43,950
Income tax expense	(740)	(1,013)	(2,276)	(2,534)
Net income (loss) for the period	2,907	41,816	(2,822)	41,416
Earnings (loss) per share				
Basic	0.20	4.08	(0.20)	4.05
Diluted	0.19	3.65	(0.20)	3.73
Weighted average number of shares outstanding				
Basic	14,232,420	10,237,209	13,826,997	10,235,365
Diluted	15,144,604	11,449,753	13,826,997	11,108,181

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Canadian dollars, amounts in thousands, unaudited)

	Three Months Ended June 30, 2011 $	Three Months Ended June 30, 2010 $	Six Months Ended June 30, 2011 $	Six Months Ended June 30, 2010 $
Net income (loss) for the period	2,907	41,816	(2,822)	41,416
Other comprehensive income (loss)				
Cumulative translation adjustment	4,615	710	5,107	(2,979)
Actuarial (loss) recognized on employee future benefits (net of taxes of $224, $590, $10 and $601)	(1,113)	(2,933)	(50)	(2,986)
Asset limit on employee future benefits (net of taxes of ($13), ($114), ($1), and ($447))	67	569	5	2,224
Total other comprehensive income (loss) for the period	3,569	(1,655)	5,062	(3,741)
Total comprehensive income for the period	6,476	40,162	2,240	37,675

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Canadian dollars, amounts in thousands, unaudited)

	Share capital $	Contributed surplus $	Accumulated other comprehensive income (loss) $	Retained earnings $	Total equity $
Balance – December 31, 2010	111,148	10,536	1,909	67,193	190,786
Net loss for the period	–	–	–	(2,822)	(2,822)
Other comprehensive income (net of tax)	–	–	5,062	–	5,062
Comprehensive income (loss) for the period	–	–	5,062	(2,822)	2,240
Employee future benefit adjustments moved to retained earnings	–	–	45	(45)	–
Employee share options *(note 9)*:					
Stock based compensation	–	1,131	–	–	1,131
Restricted share units vested	632	(632)	–	–	–
Options exercised	881	(242)	–	–	639
Redemption of convertible note *(note 7)*	7,363	(948)	–	–	6,415
Private placement *(note 8)*	54,782	–	–	–	54,782
Balance – June 30, 2011	174,806	9,845	7,016	64,326	255,993
Balance – January 1, 2010	59,083	3,198	–	32,687	94,968
Net income for the period	–	–	–	41,416	41,416
Other comprehensive loss (net of tax)	–	–	(3,741)	–	(3,741)
Comprehensive income (loss) for the period	–	–	(3,741)	41,416	37,675
Employee future benefit adjustments moved to retained earnings	–	–	762	(762)	–
Employee share options *(note 9)*:					
Stock based compensation	–	973	–	–	973
Convertible note *(note 7)*	–	2,031	–	–	2,031
Balance – June 30, 2010	59,083	6,202	(2,979)	73,341	135,647

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	June 30, 2011 $	June 30, 2010 $
Cash flows (used by) from operating activities		
Net (loss) income	(2,822)	41,416
Items not affecting cash:		
Amortization	6,902	3,293
Deferred income taxes	(1,337)	114
Foreign exchange (gain) loss	(2,502)	4,013
Finance expense	1,558	470
Fair value gain on acquisition (*note 5)*	–	(41,804)
Stock based compensation	1,131	973
	2,930	8,475
Change in non-cash working capital items		
Accounts receivable	(12,639)	(4,165)
Inventories	(4,791)	(7,801)
Prepaid expenses	(498)	855
Accounts payable and accrued liabilities and other	3,428	(1,620)
	(11,570)	(4,256)
Cash flows from (used by) financing activities		
Options exercised	639	–
Repayment of long-term debt	(6,246)	(1,434)
Proceeds from long-term debt	20,544	26,012
Net proceeds from issuance of common shares	54,782	–
Payment on capital leases	(121)	(121)
Payment of long-term debt interest	(1,168)	(364)
	68,430	24,093
Cash flows (used by) investing activities		
Additions to property, plant and equipment	(58,890)	(21,208)
Restricted cash	(1,130)	(4)
Acquisition of Thurso pulp mill *(note 5)*	–	(3,000)
Acquisition of Fortress Optical Features (*note 6*)	(750)	–
	(60,770)	(24,212)
Increase (decrease) in cash position	(3,910)	(4,375)
Foreign exchange loss on cash and cash equivalents	(894)	(3,120)
Cash and cash equivalents, beginning of year	42,559	33,205
Cash and cash equivalents, end of year	37,755	25,710

Supplementary cash flow information *(note 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 owns and operates two paper mills, the Landqart mill located in Switzerland and the Dresden mill located in Germany, and a pulp mill in Canada. Fortress' security papers include banknote, passport and visa papers. The security papers produced at the Landqart mill incorporate internationally recognized overt and covert security features which are embedded into the paper and supplemented with customer-specific features. The Landqart mill has leveraged its extensive security papers competence to develop additional commercial applications using its in-house know-how and technology of security features to create innovative paper-based security products. Fortress' specialty papers business includes non-woven wallpaper base products, as well as graphic and technical papers. The Dresden mill produces coated and uncoated wallpaper base for wallpaper manufacturers. The pulp mill, Fortress Specialty Cellulose, produces northern bleached hardwood kraft and is in the process of being converted into a dissolving pulp mill.

2. BASIS OF PRESENTATION AND ADOPTION OF IFRS

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

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

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of August 3, 2011, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of these interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

The condensed interim consolidated financial statements should be read in conjunction with the Company's Canadian GAAP annual financial statements for the year ended December 31, 2010 and the Company's first quarter 2011 condensed interim financial statements.

3. NEW ACCOUNTING PRONOUNCEMENTS

The following IFRS have been issued by the International Accounting Standards Board ("IASB"), and adopted for use in Canada by the Accounting Standards Board:

IFRS 9 - Financial Instruments

In November 2009, the IASB issued IFRS 9, Financial Instruments. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit and loss. IFRS 9 also replaces the models for measuring equity instruments with recognition at fair value through profit or loss or at fair value through other comprehensive earnings.

IFRS 9 is effective for annual periods beginning on or after January 1, 2013. The Company is currently assessing the impact of this standard on the financial statements.

IFRS 10 - Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10, Consolidated Financial Statements. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. This IFRS defines the principle of control and establishes control as the basis for determining which entities are consolidated in an entity's consolidated financial statements. IFRS 10 sets out three elements of control: a) power over the investee; b) exposure, or rights, to variable returns from involvement with the investee; and c) the ability to use power over the investee to affect the amount of the investors return. IFRS 10 sets out the requirements on how to apply the control principle. IFRS 10 and IFRS 12 supersede IAS 27, Consolidated and Separate Financial Statements and SIC-12, Consolidation – Special Purpose Entities.

This standard is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted if adopted along with IFRS 11, IFRS 12, IAS 27 (revised) and IAS 28 (revised). The Company is currently assessing the impact of these standards on the financial statements.

IFRS 11 – Joint Arrangements

In May 2011, the IASB issued IFRS 11, Joint Arrangements, which provides guidance on accounting for joint arrangements. If an arrangement has joint control, IFRS 11 classifies joint arrangements as either joint operations or joint ventures, depending on the rights and obligations of the parties involved.

A joint operation is an arrangement where the jointly controlling parties have rights to the assets and obligations in respect of the liabilities relating to the arrangement. An entity accounts for a joint operation by recognizing its portion of the assets, liabilities, revenues and expenses. A joint venture is an arrangement where the jointly controlling parties have rights to the net assets of the arrangement. A joint venture is accounted for using the equity method. Proportionate consolidation is no longer permitted.

This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. This standard is not expected to have a significant impact on the financial statements as Fortress currently has no joint arrangements.

IFRS 12 – Disclosure of Interests in Other Entities

In May 2011, the IASB issued IFRS 12, Disclosure of Interests in Other Entities. IFRS 12 outlines the disclosure requirements for interests in subsidiaries and other entities to enable users to evaluate the risks associated with interests in other entities and the effects of those interests on an entity's financial position, financial performance and cash flows. IFRS 10 and IFRS 12 supersede IAS 27, Consolidated and Separate Financial Statements and SIC-12, Consolidation – Special Purpose Entities.

This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. The Company is currently assessing the impact of this standards on the financial statements.

IFRS 13 – Fair Value Measurement

In May 2011, the IASB issued IFRS 13, Fair Value Measurement ("IFRS 13"). This standard defines fair value, sets out a single IFRS framework for measuring fair value and outlines disclosure requirements about fair value measurements. IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is a market-based measurement, not an entity-specific measurement so assumptions that market participants would use should be applied in measuring fair value.

This standard is effective for annual periods on or after January 1, 2013, with earlier application permitted. This IFRS is to be applied prospectively as of the beginning of the annual period in which it is initially applied and the disclosure requirements do not need to be applied in comparative periods before initial application. Fortress is currently assessing the impact of this standard on the financial statements.

IAS 19 – Employee Future Benefits

In June 2011, the IASB issued an amended version of IAS 19, Employee Benefits. The amendments to IAS 19 are meant to improve the quality, transparency and comparability of information presented for post-employment benefits. For defined benefit plans, the amendments eliminate the option to defer actuarial gains and losses on the balance sheet through the "corridor method". The amendments also require any remeasurement gains or losses, including actuarial gains and losses, to be recognized immediately and presented in other comprehensive income, eliminating the option to recognize and present these through the income statement. Additional disclosures will also be required to present better information about the characteristics, amounts recognized, and risks related to defined benefit plans.

The amendments to IAS 19 are effective for financial years beginning on or after January 1, 2013 with earlier adoption permitted. The Company is currently assessing the impact of these amendments on the financial statements.

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

4. TRANSITION TO IFRS

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

(i) Transition elections

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

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

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

	Ref	December 31, 2010 $	June 30, 2010 $	January 1, 2010 $
Equity				
Equity as reported under Canadian GAAP		180,266	129,976	86,584
IFRS adjustments increase (decrease):				
Foreign exchange on property, plant and equipment	a	3,321	(2,022)	2,176
Foreign exchange on inventory	a	(23)	958	(816)
Employee future benefits – actuarial gains and losses	b	(8,753)	(9,982)	(6,295)
Property, plant and equipment revaluation	f	16,833	16,833	16,833
Employee future benefits – asset limit	g	(43)	(7)	(2,784)
Deferred income tax	h	(1,572)	(920)	(1,199)
Deferred expenses	i	–	–	(476)
Long term debt revaluation	j	757	811	945
Equity as reported under IFRS		190,786	135,647	94,968

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

	Ref	Year ended December 31, 2010 $	Six months ended June 30, 2010 $
Comprehensive income			
As reported under Canadian GAAP		34,753	40,557
Increase (decrease) in net income for:			
Deferred income tax	h	(143)	(5)
Deferred expenses	i	476	476
Interest expense	j	(222)	(105)
Foreign exchange on translation of foreign operations	k	(613)	811
Depreciation and other	k	52	98
Stock based compensation	l	(227)	(169)
Redemption of convertible note	m	(246)	–
Employee future benefits	n	33	(247)
		33,863	41,416
Increase (decrease) in comprehensive income for:			
Cumulative translation adjustment	k	1,915	(2,979)
Employee future benefits – actuarial gains and losses	b	(1,582)	(2,986)
Employee future benefits – asset limit	g	2,224	2,224
		2,557	(3,741)
As reported under IFRS		36,420	37,675

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

(b) Under IFRS, the Company recognizes actuarial gains and losses arising from the re-measurement of employee future benefit obligations in other comprehensive income as they arise. Under Canadian GAAP, the company applied the corridor method of accounting for such gains and losses. Under this method, gains and losses are recognized only if they exceed specified thresholds. The carrying value of the net asset for employee future benefits was reduced by $6,295 as at January 1, 2010 to recognize previously unamortized accumulated actuarial gains and losses. Actuarial losses of $3,587 previously unrecognized under Canadian GAAP were recognized for the six months ended June 30, 2010 for IFRS. Actuarial losses of $1,900 previously unrecognized under Canadian GAAP were recognized for the year ended December 2010 for IFRS.

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

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

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

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

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

(g) Under IFRS, IFRIC 14 provides specific guidance on the calculation of the amount of an employee future benefit asset a company can recognize. Based on this guidance the employee future benefit recognized on the balance sheet of the Company will be $0.8 million as at January 1, 2010, $nil as at June 30, 2010 and $1.8 million as at December 31, 2010.

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

	Ref	December 31, 2010 $	June 30, 2010 $	January 1, 2010 $
Property, plant and equipment revaluation	a	3,273	2,721	2,932
Employee future benefits – actuarial gains and losses	b	(1,588)	(1,730)	(1,201)
Employee future benefits – asset limit	g	(113)	71	(532)
		1,572	920	1,199

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

(i) Under IFRS, all acquisition related costs of the acquirer in a business combination must be accounted for as expenses in the period in which they were incurred. Under Canadian GAAP incremental costs that were directly attributable to the purchase were included in the purchase price. As a result of this change the Company has charged $476 in deferred expenses previously recognized as an asset under Canadian GAAP directly to equity as at January 1, 2010. Net income was also increased by $476 for the six months ended June 30, 2010 and increased by $476 for the year ended December 31, 2010 as a result of this change.

(j) Upon conversion to IFRS a non-interest bearing loan with a principal amount of $5,366 was valued at amortized cost of $4,440 using an imputed interest rate of 5%. This resulted in a decrease in long term debt and an increase in retained earnings of $945 as at January 1, 2010. The imputed interest expense was $105 for the six months ended June 30, 2010 and $222 for the year ended December 31, 2010.

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

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

As such, depreciation expense and property, plant and equipment were decreased by $98 for the six months ended June 30, 2010 and decreased by $52 for the year ended December 31, 2010.

Other comprehensive income was decreased by $2,979 for the six months ended June 30, 2010 and increased by $1,915 for the year ended December 31, 2010 to record a cumulative translation adjustment.

(l) Under IFRS, when share based payment awards vest in installments over the vesting period (graded vesting), each installment is accounted for as a separate arrangement. This treatment is allowed under Canadian GAAP but was not used by the Company. The Company's former policy under Canadian GAAP was to recognize stock based compensation straight line over the vesting period. This change in treatment has resulted in an increase to contributed surplus and a decrease in retained earnings of $110 for share-based awards that were issued to officers of the Company but had not fully vested as at January 1, 2010. For the six months ended June 30, 2010 the Company recorded an increase in contributed surplus and an increase in stock-based compensation of $169. For the year ended December 31, 2010, the Company recorded an increase in contributed surplus and an increase in stock based compensation of $227.

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

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

(iii) Adjustments to the statements of cashflows

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

5. ACQUISITION OF THURSO PULP MILL

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

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

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

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

The acquisition has been accounted for as follows:

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

6. ACQUISITION OF FORTRESS OPTICAL FEATURES

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

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

The acquisition has been accounted for as follows:

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

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

7. LONG-TERM DEBT

	June 30, 2011 $	December 31, 2010 $	January 1, 2010 $
Credit agreement with bank maturing 2013; interest at 2.65% secured by current assets (EUR 385; Dec 2010 : EUR 2,431; Jan 2010 : EUR 3,223)	538	3,238	4,835
Credit agreement with lender maturing 2018; interest at 6.2% and 7.1% secured by fixed assets (EUR 20,906; Dec 2010 : EUR 15,377; Jan 2010 : EUR 0) (a)	29,042	20,481	–
Credit agreement with bank maturing 2012; interest at 4.8% unsecured (CHF 2,355; Dec 2010 : CHF 3,140; Jan 2010 : CHF 4,710)	2,699	3,344	4,760
Credit agreement with bank maturing 2011, 2013 and 2018; interest up to 3.1% and 4.9% secured by fixed assets (CHF 6,480; Dec 2010 : CHF 7,560; Jan 2010 : CHF 8,820)	7,426	8,048	8,914
Credit agreement with lender maturing 2016; unsecured (CHF 4,715; Dec 2010: CHF 4,598; Jan 2010: CHF 4,375) (b)	5,403	4,895	4,422
Capital leases; interest at 4.0% (EUR 59; Dec 2010 : EUR 147; Jan 2010 : EUR 324)	83	196	486
Credit agreement with lender maturing 2015; interest at 7% unsecured (c)	–	6,248	–
Credit agreement with lender maturing 2014; interest up to 5.5% secured by assets (d)	15,915	3,769	–
	61,106	50,219	23,417
Less: Current portion	(8,608)	(8,977)	(5,378)
	52,498	41,242	18,039

Borrowings under the above agreements require maintenance of certain financial and non-financial covenants. The Company has been in compliance with all covenants for the three months ended June 30, 2011.

(a) The credit agreement is a facility for up to EUR 22.2 million, of which EUR 22.2 million has been drawn as at June 30, 2011. The facility bears interest at a rate of 6.2% up until March 2011. Beginning in March 2011, the loan is repayable in equal installments over 7 years and bears interest at a rate of 7.1%.

Interest has been calculated at 7.6% using the effective interest rate method.

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

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

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

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

The Company has initially recorded a liability portion of $12,969 and an equity portion of $2,031 in contributed surplus. The liability portion was valued using a 10.8% initial interest rate.

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

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

(d) The credit agreement is a facility for up to $102.4 million, granted to Fortress Specialty Cellulose to support the conversion to dissolving pulp and co-generation capital expenditure programs. At December 31, 2010, $4.7 million has been drawn on this facility. At June 30, 2011, $16.5 million has been drawn on this facility. The facility bears interest at a rate of 5% for the first five years of the loan and at a rate of up to 5.5% for the second five years of the loan. Commencing after two years, the facility is repayable in equal quarterly installments up to June 30, 2020. Interest for the first two years of the credit agreement is added to the principal of the loan.

Interest has been calculated at 5.6% using the effective interest rate method.

8. SHARE CAPITAL

(a) **Authorized:**

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

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

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

	Number of Shares	Share Capital $
Balance, December 31, 2009	10,233,500	59,083
Private placement	1,900,050	42,344
Restricted share units vested (*note 9*)	65,038	684
Options exercised (*note 9*)	85,000	958
Shares issued on redemption of Convertible Note (*note 7*)	400,000	8,079
Balance, December 31, 2010	12,683,588	111,148
Private placement	1,112,050	54,782
Restricted share units vested *(note 9)*	16,968	632
Options exercised *(note 9)*	80,250	881
Shares issued on redemption of Convertible Note *(note 7)*	350,000	7,363
Balance, June 30, 2011	14,242,856	174,806

In February 2011, the Company completed a private placement of 1,112,050 shares for total net proceeds of $54,782 after transaction costs of $2,765.

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

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

The weighted average fair value of the options granted in 2009 was $2.98 an option at the grant date using the Black Scholes option pricing model. No options were granted in 2010 or during the six months ended June 30, 2011. Option pricing models require the input of highly subjective assumptions including the expected volatility. Changes in the assumptions can materially affect the fair value estimate, and, therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options. Assumptions used in the pricing model are as follows:

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

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

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

	Number of options	**Exercise Price**
Balance, December 31, 2009	740,175	$ 8.00
Exercised	(85,000)	8.00
Balance, December 31, 2010	655,175	$ 8.00
Exercised	(80,250)	8.00
Balance, June 30, 2011	574,925	$ 8.00

As at June 30, 2011, 574,925 stock options were exercisable (December 31, 2010: 643,508). The stock options issued have various vesting dates that range from one to three years from the IPO or grant dates.

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.

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

	Number of DSUs	**Expense recognized $**
Balance, December 31, 2009	26,000	185
Granted	121,481	5,134
Redeemed	(8,458)	151
Balance, December 31, 2010	139,023	5,470
Granted	2,557	122
Balance, June 30, 2011	141,580	5,592

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.

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

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

	Number of RSUs
Balance, December 31, 2009	157,626
Granted	222,454
Vested	(65,038)
Balance, December 31, 2010	315,042
Granted	17,128
Vested	(16,968)
Balance, June 30, 2011	315,202

10. ACCUMULATED OTHER COMPREHENSIVE INCOME

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

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

11. SEGMENTED INFORMATION

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

	Three months ended June 30, 2011				
	Wallpaper	**Security**	**Pulp**	**Corporate**	**Fortress Paper Consolidated**
	$	**$**	**$**	**$**	**$**
Sales	36,566	13,379	39,961	–	89,906
Operating income (loss)	6,804	(6,779)	3,316	(2,722)	619
Amortization[1]	(702)	(1,852)	(840)	–	(3,394)
Stock-based compensation[1]	-	-	-	(588)	(588)
Capital expenditures	3,144	3,953	30,778	–	37,875
Total assets	65,663	150,979	152,986	17,731	387,359

Sales by geographic area	%
Europe	50.0
Asia	44.4
Other	5.6
Total	100.0

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

	Three months ended June 30, 2010				
	Wallpaper	**Security**	**Pulp**	**Corporate**	**Fortress Paper Consolidated**
	$	**$**	**$**	**$**	**$**
Sales	28,930	18,070	13,544	–	60,544
Operating income (loss)	3,874	83	(1,124)	(459)	2,374
Amortization[1]	(493)	(819)	(609)	–	(1,921)
Stock-based compensation[1]	–	–	–	(671)	(671)
Capital expenditures	1,331	9,612	1,323	–	12,266
Total assets	50,223	91,604	84,364	4,274	230,465

Sales by geographic area	%
Europe	95.6
Other	4.4
Total	100.0

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

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

	Six months ended June 30, 2011				
	Wallpaper	Security	Pulp	Corporate	Fortress Paper Consolidated
	$	$	$	$	$
Sales	73,567	26,280	75,547	-	175,394
Operating income (loss)	13,810	(13,422)	2,374	(5,245)	(2,483)
Amortization[1]	(1,351)	(3,801)	(1,750)	-	(6,902)
Stock-based compensation[1]	-	-	-	(1,131)	(1,131)
Capital expenditures	5,134	16,912	44,076	-	66,122
Total assets	65,663	150,979	152,986	17,731	387,359

Sales by geographic area	%
Europe	53.5
Asia	36.0
North America	1.8
Other	8.7
Total	100.0

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

	Six months ended June 30, 2010				
	Wallpaper	Security	Pulp	Corporate	Fortress Paper Consolidated
	$	$	$	$	$
Sales	60,124	37,181	13,543		110,848
Operating income (loss)	9,579	246	(1,124)	(2,898)	5,803
Amortization[1]	(1,072)	(1,612)	(609)	-	(3,293)
Stock-based compensation[1]	-	-	-	(973)	(973)
Capital expenditures	3,640	18,390	1,323	-	23,353
Total assets	50,223	91,604	84,364	4,274	230,465

Sales by geographic area	%
Europe	92.2
North America	3.0
Other	4.8
Total	100.0

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

12. SUPPLEMENTARY CASH FLOW INFORMATION

Non cash item

During the six months ended June 30, 2011, 350,000 common shares of the Company were issued for the redemption of the Convertible Note *(note 7)*.