



FORTRESS PAPER LTD

Q3 2013

FOR THE THREE AND NINE MONTHS ENDED

SEPTEMBER 30, 2013



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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 November 12, 2013. The MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements and the notes thereto for the three and nine month periods ended September 30, 2013 (available on SEDAR at www.sedar.com). This MD&A provides a review of the significant developments that have impacted the Company's performance during the quarter ended September 30, 2013 relative to the previous quarter and prior year comparative quarter. The financial information contained herein has been prepared in accordance with International Financial Reporting Standards ("IFRS"), including IAS 34, Interim Financial Reporting, which as of January 1, 2011 is the required reporting framework for Canadian publicly accountable enterprises.

This MD&A contains certain forward-looking information that reflects the current views and/or expectations of the Company with respect to its expectations, beliefs, assumptions, estimates and forecasts about its business and the industries and markets in which it operates. The reader is cautioned that statements comprising forward-looking information are not guarantees of future performance and involve known and unknown risks, uncertainties, assumptions and other factors which are difficult to predict and that may cause actual results or events to differ materially from those anticipated in such forward-looking information. Accordingly, readers should not place undue reliance on forward-looking information. Examples of such forward-looking information that may be contained in this document include statements regarding: growth and future prospects of our business; market conditions for dissolving pulp and our other products; expected returns on certain business segments; availability of funds for debt allocation; our perceptions of the industry and markets in which we operate and anticipated trends in such markets and in the countries in which we do business; the submission of a tender for a new power supply agreement; the securing of new purchase orders; expectations surrounding and resulting from the final determination in MOFCOM's anti-dumping investigation; benefits that may accrue to the Company as a result of certain acquisitions, dispositions, capital expenditure programs, equipment upgrades and maintenance shut-downs; 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 long term; that the duty imposed by MOFCOM, if unchanged, may result in the supply of dissolving pulp decreasing significantly with a corresponding price increase in the short to medium term; that the swing mill strategy at the Fortress Specialty Cellulose mill will mitigate 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 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; 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, in respect of the delivery of power at the cogeneration facility, including as a result of equipment failures, labour issues, the complex integration of processes and equipment and other factors; labour relations; failure to meet regulatory requirements; changes in the market; potential downturns in economic conditions; fluctuations in the price and supply of required materials; fluctuations in the market price for products sold; foreign exchange fluctuations; trade restrictions or import duties imposed by foreign governments, including the imposition of a final anti-dumping tariff on dissolving pulp exports into China; availability of financing (as necessary); dependence on major customers; and other risk factors detailed in our Annual Information Form dated March 28, 2013 available on SEDAR at www.sedar.com and other filings with the Canadian securities regulatory authorities. These risks, as well as others, could cause actual results and events to vary significantly. The Company does not undertake any obligation to update any forward-looking information, except as required by applicable securities law.

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

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

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

Description of Business

The Company was incorporated on May 30, 2006 under the laws of the Province of British Columbia. During the nine month period ended September 30, 2013, the Company operated internationally in three distinct business segments: the Dissolving Pulp Segment, the Security Paper Products Segment, and the Specialty Papers Segment. The Specialty Papers Segment was sold on April 30, 2013. 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 Canada. The mill expanded into the renewable energy generation sector in October 2013. The Company is also seeking to expand its dissolving pulp capacity with the 2012 acquisition of the Fortress Global Cellulose (“FGC”) mill located at Lebel-sur-Quévillon, Québec, Canada, which the Company is evaluating to convert into a dissolving pulp mill and re-start the cogeneration facility. The Company operates its security paper products business 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. Fortress’ business segments were re-classified in 2012 given changes in the nature of products being produced.

The Company previously operated its specialty papers business 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.

Overall Performance

Fortress reported adjusted net loss from continuing operations of \$15.6 million, or diluted loss per share of \$1.07 for the third quarter of 2013 on sales of \$53.2 million. In the second quarter of 2013, the Company reported adjusted net loss from continuing operations of \$20.6 million or diluted loss per share of \$1.42 on sales of \$59.9 million, and for the third quarter of 2012, adjusted net loss from continuing operations of \$23.2 million or diluted loss per share of \$1.61 on sales of \$38.3 million. Adjusted net loss in the second quarter of 2013 was impacted by an expense of approximately \$3.5 million recorded as a deferred tax accrual.

Fortress reported a net loss from continuing operations of \$13.4 million, or diluted loss per share of \$0.92 for the third quarter of 2013. In the second quarter of 2013, the Company reported a net loss from continuing operations of \$20.9 million or diluted loss per share of \$1.43, and for the third quarter of 2012, net loss from continuing operations of \$24.1 million or diluted loss per share of \$1.67.

Fortress reported a net loss, including discontinued operations, of \$12.4 million, or diluted loss per share of \$0.85 for the third quarter of 2013. In the second quarter of 2013, the Company reported a net income, including discontinued operations of \$134.1 million or diluted earnings per share of \$9.23. Included in discontinued operations was a \$153.3 million gain on the sale of the Dresden mill. In the third quarter of 2012, the Company reported a net loss of \$19.1 million or diluted loss per share of \$1.32, including discontinued operations.

EBITDA loss from continuing operations of the Company was \$7.3 million for the three months ended September 30, 2013. For the three months ended June 30, 2013, EBITDA loss was \$8.4 million and for the three months ended September 30, 2012, EBITDA loss was \$14.9 million.

Excluding corporate costs, combined EBITDA loss including discontinued operations was \$5.0 million in the three months ended September 30, 2013. The Dissolving Pulp Segment generated EBITDA loss of \$6.6 million and the Security Paper Products Segment generated EBITDA of \$1.6 million. Corporate costs contributed \$2.3 million to EBITDA loss.

The Dissolving Pulp Segment has experienced another difficult quarter due to depressed market prices, delays in the cogeneration facility completion and operational and maintenance issues. The cogeneration facility project was successfully completed on October 2, 2013 and began delivering power to the Hydro Québec grid at the contracted commercial rate. This is a significant milestone for the reduction of the overall cost structure at the mill.

As a result of a strategic assessment and testing of alternatives for the FSC mill, the Company has been pursuing a strategy of modifying the mill to be capable of swinging production from dissolving pulp to northern bleached hardwood kraft (NBHK) pulp. This redesign is expected to enable the Company to maximize margins in response to changing market conditions.

The Security Paper Products Segment has experienced a third consecutive quarter with sales, volumes and revenues significantly higher relative to any comparative period in 2012 and 2011. The mill continues to implement new programs to improve efficiencies and profitability. EBITDA for the Security Paper Products Segment for the quarter ended September 30, 2013 was \$7.4 million higher when compared to the third quarter of 2012, and \$1.1 million higher compared to the previous quarter. However, less than favourable conditions, including the strength of the Swiss franc against the Euro, overcapacity in the banknote paper industry and increased competition for orders, continue to adversely impact the results of the Security Paper Products Segment.

Management's Outlook

Dissolving Pulp Segment

Dissolving pulp markets remained challenging during the third quarter of 2013 due to continued excess supply. The average market price of dissolving pulp in China, as reported by China Chemical Fibers & Textiles Consultancy Group (CCF), a leading professional data analysis company relied upon in the dissolving pulp industry, was approximately US\$880 per air dried metric tonne (ADMT) during the third quarter of 2013. Management believes that the current depressed dissolving pulp prices are indicative of unusual market conditions and are not sustainable in the long term. Following the interim anti-dumping duty announcement of the Ministry of Commerce of China ("MOFCOM") on November 6, 2013 for Canadian, American and Brazilian companies, based on its preliminary assessment, the Company believes that the supply of dissolving pulp will decrease significantly and lead to a price increase in the short to medium term. We also believe that if the interim duty for all other unnamed Canadian, American and Brazilian dissolving pulp producers remains unchanged, it will have a long term deterrent effect on supply dynamics. See "Subsequent Events – China Anti-Dumping Investigation".

Prior to the third quarter of 2013, viscose producers in China had decreased operating rates to manage inventory and

stabilize prices. However, operating rates in the third quarter have increased which has eroded viscose staple fibre prices to their lowest levels in many months. Dissolving pulp is the main raw material input for the production of viscose staple fibre. Cotton prices remained relatively stable in China during the third quarter of 2013 and well above viscose staple fibre prices. Viscose staple fibre is a substitute for cotton.

The Fortress Specialty Cellulose mill operated more efficiently during the third quarter of 2013 relative to the prior quarter. Cash costs continued to improve in the third quarter but were higher than expected due to operational and maintenance issues and delay in the cogeneration facility start-up.

Shortly after quarter end the cogeneration project was successfully completed and the facility commenced delivering power to the Hydro Québec grid at the contracted commercial rate. The cogeneration start-up was delayed due to unexpected mechanical failure of the high pressure water pump and the back-up pump which were resolved when a new supplier was engaged and the 100 hour test could be completed.

Although depressed dissolving pulp prices continue to impact FSC mill results, we expect to realize significant cost-savings from production improvements, cost reduction initiatives and the cogeneration facility in the fourth quarter of 2013 and into fiscal 2014.

Finished goods inventory levels of dissolving pulp at the end of the third quarter were higher than previous periods. During the third quarter of 2013, the FSC mill implemented a plan to reduce logistics, transportation and distribution costs. Dissolving pulp inventory levels were higher due to the mill retaining ownership of the inventory for a longer period in the sales cycle, as well as ongoing negotiations with Chinese buyers resulting from the uncertainty surrounding the ongoing China dissolving pulp anti-dumping investigation. Subsequent to the quarter end, dissolving pulp sales with our existing customers have resumed.

The Company is evaluating the impact of the MOFCOM decision on the FGC mill project in Lebel-sur-Quevillon, Quebec. The Company is also continuing the process of exploring strategic options for the FGC mill project 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. The Company is currently in discussions with prospective equity investors for the project and is in the process of discussing potential revised terms for its project financing to provide greater flexibility. Approximately \$25 million has been spent to date on the FGC mill project. 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.

Due to a change in timelines relating to the FGC mill project, the Company reviewed with Hydro Québec its electricity supply agreement dated September 28, 2012, resulting in the agreement no longer being in effect. The FGC mill intends to submit a tender for a new power supply agreement under Hydro Québec's power purchase program request for proposals expiring December 21, 2013. Among other things, the new tender will include a request for an increase in the amount of power to be supplied by the cogeneration facility from the previously approved 34 megawatts to 42 megawatts. There is no assurance that the Company will be granted another power supply agreement.

Security Paper Products Segment

The Landqart mill has had a strong third quarter order intake including a contract extension on one of the mill's more significant orders. The pipeline of opportunities to year end is strong and consists of a mix of tender and repeat order possibilities which, if successfully secured, will further improve an already stable order book for next year.

Significant Developments

Sale of the Dresden Mill

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 €160 million (approximately \$213 million) subject to working capital and other adjustments, to Glatfelter Gernsbach GmbH & Co. KG, a subsidiary of P.H. Glatfelter Co. The transaction excluded cash and long-term debt associated with the Dresden mill. Concurrent with the sale, the associated long term debt was repaid and the factored accounts receivable

of the Dresden mill were repurchased. An early prepayment penalty of \$1.2 million 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 the sale of the Dresden mill was \$154.3 million, as summarized below. Adjustments to the purchase price in respect of tax liabilities for periods prior to the closing date are still being finalized and are currently based on management's best estimate, which could be subject to change in the future.

(thousands of dollars, unaudited)	<u>April 30, 2013</u>
Book value of net assets disposed of:	
Restricted cash	531
Accounts receivable	26,832
Inventories	12,992
Prepaid expenses	210
Property, plant and equipment	31,553
Accounts payable and accrued liabilities	(16,723)
Income taxes payable	(3,932)
Deferred income tax liability	(373)
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Net assets disposed of	51,090
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Sale proceeds:	
Cash	212,240
Less: purchase price adjustments	(1,649)
Less: directly attributable costs	(2,416)
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Total net proceeds	208,175
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Profit on disposal before recycling of cumulative translation adjustment	157,085
Cumulative translation adjustment	(2,820)
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Gain on disposal	<u>154,265</u>

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

Normal Course Issuer Bid

The Company announced in August 2013 its intentions to commence a normal course issuer bid to acquire outstanding common shares, 6.5% convertible unsecured subordinated debentures, and 7.0% convertible unsecured subordinated debentures of the Company up to an aggregate maximum amount of \$15 million. However, in light of the recent MOFCOM announcement and the uncertainties relating to the preliminary duty imposed, the Company intends to re-evaluate the most optimal use of capital given the circumstances. No purchases have been made to date.

Subsequent Event

China Anti-Dumping Investigation

In February 2013, MOFCOM announced the commencement of an anti-dumping investigation on the importing of cellulose pulp originating from Canada, the United States and Brazil, after receiving a petition from certain manufacturers in China. The announcement included Fortress Specialty Cellulose Ltd. ("Fortress Specialty") as one of the Canadian producers that is subject to the investigation. Fortress Specialty registered with MOFCOM the same month and submitted its responses to MOFCOM.

On November 6, 2013, the Company announced that MOFCOM made a preliminary determination to impose an interim duty on the import of dissolving pulp into China from each of the originating countries. The interim duty applied against Fortress Specialty's dissolving pulp imports has been calculated at 13% of the CIF price to China, and will be payable in cash bonds in respect of prospective imports during the period between MOFCOM's preliminary and final determination. The interim duty applied against the Company's imports is consistent with that applied against other Canadian dissolving pulp importers who were specifically named in the investigation. The interim duty applied to American dissolving pulp producers ranged from 18.7% to 21.7% and 6.7% for one Brazilian producer which were named in the investigation. All other unnamed current or future Canadian, American and Brazilian dissolving pulp producers will be subject to an interim duty of 50.9%, 49.8% and 49.4%, respectively. It appears from the preliminary determination that the interim duty applicable to unnamed Canadian dissolving pulp producers would apply to dissolving pulp produced by the FGC mill to the extent such duty remains in effect at the time the FGC mill is producing dissolving pulp and exports it into China.

The Company believes that MOFCOM's preliminary decision may serve to materially harm the business of Chinese viscose staple fibre (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. The Company is evaluating its legal options to reverse the preliminary decision of MOFCOM. Fortress Specialty will initially have 10 days to submit a response to MOFCOM's preliminary determination. The Company is also preparing further submissions to be made to MOFCOM prior to its final determination and is reviewing the possibility of requesting a public hearing. MOFCOM's final determination is expected to be made in February 2014, unless the investigation period is further extended. If MOFCOM calculates a final dumping margin lower than 13%, any excess cash bonds paid on shipments during the interim period will be refunded. If the final dumping margin is higher than 13%, any outstanding cash bonds will be fully applied towards the formal import duty on imports subsequent to the final determination, however no additional amount will be payable for imports during the interim period.

Upon the completion of the investigation and MOFCOM's final determination, an application may be made by the Canadian Government to the World Trade Organization (WTO) to review MOFCOM's determination. WTO cases typically have a duration of approximately two years, inclusive of appeal processes. Although Fortress Paper believes that it has strong arguments against the imposition of a dumping duty, there is no assurance that it will be successful in reversing MOFCOM's preliminary determination or in securing the Canadian Government's support in commencing a WTO review. If the Company is not successful in reversing MOFCOM's preliminary determination, there may be an impact on the carrying value of the Company's dissolving pulp assets.

Although the Company is in the process of evaluating the impact of the interim duty on its dissolving pulp business, the Company has, partly to mitigate the adverse effects of the dissolving pulp duty, completed successful 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 now 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 and specialty non-paper grade pulps. The FSC mill carried a small NBHK inventory at September 30, 2013 from trial runs of NBHK pulp which began four days prior to the end of the third quarter 2013.

The flexibility derived from the FSC mill's swing mill strategy is expected to allow the Company to mitigate the adverse impacts resulting from the imposition of the dumping tariff on dissolving pulp exports into China. The Company anticipates that the adverse impact of any 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.

Selected Quarterly Information

(thousands of dollars, except per share amounts, exchange rates and shares outstanding, unaudited)

	Q3 2013	Q2 2013	Q1 2013	Q4 2012
Sales from continuing operations	53,160	59,883	57,559	58,748
Net (loss) income from continuing operations	(13,427)	(20,851)	(18,814)	(9,784)
Net (loss) income ⁽¹⁾	(12,436)	134,125	(12,373)	(4,227)
Basic net (loss) income per share from continuing operations	(0.92)	(\$1.43)	(\$1.30)	(\$0.68)
Diluted net (loss) income per share from continuing operations	(0.92)	(\$1.43)	(\$1.30)	(\$0.68)
Basic net (loss) income per share ⁽¹⁾	(0.85)	\$9.23	(\$0.85)	(\$0.29)
Diluted net (loss) income ⁽¹⁾	(0.85)	\$9.23	(\$0.85)	(\$0.29)
Weighted average shares outstanding - Basic (thousands)	14,561	14,536	14,502	14,492
Weighted average shares outstanding - Diluted (thousands)	14,561	14,536	14,502	14,492
Average Swiss/Canadian exchange rate ⁽²⁾	1.1147	1.0862	1.0837	1.0645
Average Euro/Canadian exchange rate ⁽²⁾	1.3759	1.3367	1.3312	1.2857
Average US dollar/Canadian exchange rate ⁽²⁾	1.0386	1.0231	1.0083	0.9913

(thousands of dollars, except per share amounts, exchange rates and shares outstanding, unaudited)

	Q3 2012	Q2 2012	Q1 2012	Q4 2011
Sales from continuing operations	38,257	43,208	23,711	14,644
Net (loss) income from continuing operations	(24,051)	6,005	(14,206)	(14,340)
Net (loss) income ⁽¹⁾	(19,061)	12,289	(10,670)	(9,171)
Basic net (loss) income per share from continuing operations	(\$1.67)	\$0.42	(\$0.99)	(\$1.00)
Diluted net (loss) income per share from continuing operations	(\$1.67)	\$0.40	(\$0.99)	(\$1.00)
Basic net (loss) income per share ⁽¹⁾	(\$1.32)	\$0.86	(\$0.75)	(\$0.64)
Diluted net (loss) income ⁽¹⁾	(\$1.32)	\$0.82	(\$0.75)	(\$0.64)
Weighted average shares outstanding - Basic (thousands)	14,394	14,322	14,306	14,298
Weighted average shares outstanding - Diluted (thousands)	14,394	15,032	14,306	14,298
Average Swiss/Canadian exchange rate ⁽²⁾	1.0340	1.0784	1.0871	1.1216
Average Euro/Canadian exchange rate ⁽²⁾	1.2445	1.2956	1.3129	1.3790
Average US dollar/Canadian exchange rate ⁽²⁾	0.9953	1.0105	1.0011	1.0232

⁽¹⁾ Including discontinued operations

⁽²⁾ Source – Bank of Canada (average noon rate for the period).

Fluctuations in quarterly results reflect significant transactions and developments within the Company. In the fourth quarter of 2011, the Dissolving Pulp Segment was re-defined as the FSC mill transitioned from a NBHK pulp producer to a dissolving pulp producer. Results were impacted by the mill being in either shutdown or ramp-up mode for much of the fourth quarter of 2011 with production of dissolving pulp commencing in December 2011. Start-up continued through the first quarter of 2012 with all dissolving pulp revenue and costs for production from December 2011 through March 18, 2012 being capitalized in property, plant and equipment for accounting purposes. Throughout the remainder of 2012, production rates improved in the Dissolving Pulp Segment, albeit at a slower pace than first anticipated with the FSC mill in ramp up for the duration without reaching full operational capacity. 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 to overshadow improved production. The first quarter of 2013 was characterized by production challenges and the lowest realized dissolving prices experienced to date, which contributed to disappointing results from the Dissolving Pulp Segment. Results improved in the second quarter of 2013 compared to the prior quarter after the planned ten day maintenance shutdown. The third quarter of 2013 was characterized by continued depressed dissolving pulp prices, trial runs of NBHK, and higher than prior inventory levels.

Product mix, high raw material costs, pricing pressure, a strong Swiss currency, and less than optimal production efficiency at the Landqart mill contributed to a disappointing and difficult 2011 year for the Security Paper Products Segment which materially impacted the Company's quarterly results throughout 2011 and 2012. Net income for the second quarter of 2012 was significantly impacted by the sale of the hydropower assets and associated real estate at the Landqart mill to a Swiss utility company for proceeds of CHF18 million. An increase in volume sold in the first three quarters of 2013 have contributed to improving metrics, higher sales and better results for the Security Paper Products Segment. In addition the results were impacted by the sale of non-core assets as follows: a \$1.9 million realized gain in the first quarter of 2013, a \$0.8 million realized loss in the second quarter of 2013 and a \$4.1 million realized gain in the third quarter of 2013. Included in the third quarter of 2013 net loss is a \$1.3 million legal provision.

Included in the second quarter of 2013 results is the realized gain on the sale of the Specialty Papers Segment. Discontinued operations also incorporate the results of this segment through to the completion of the sale on April 30, 2013

Third Quarter 2013 Earnings Review

Three Months Ended September 30

Overview

Fortress reported an adjusted net loss from continuing operations of \$15.6 million, or diluted loss per share of \$1.07 for the third quarter of 2013 on sales of \$53.2 million. In the second quarter of 2013, the Company reported an adjusted net loss of \$20.6 million or diluted loss per share of \$1.42 on sales of \$59.9 million, and for the third quarter of 2012, an adjusted net loss of \$23.2 million or diluted loss per share of \$1.61 on sales of \$38.3 million.

Cost of products sold from continuing operations was \$49.5 million for the three months ended September 30, 2013 compared to \$58.3 million for the three months ended June 30, 2013. In the third quarter of 2012, cost of products sold was \$47.0 million.

Sales and cost of products sold in the third quarter are slightly lower when compared to the previous quarter; however, the operating results were offset somewhat by a gain on the sale of a non-core asset and lower income tax recovery. The Company also realized a gain on the sale of the Dresden mill of \$1.0 million during the quarter related to the final closing working capital adjustment.

Selling, general and administrative ("SG&A") expenses for continuing operations were \$12.2 million for the third quarter of 2013 compared to \$9.9 million for the second quarter of 2013. The prior year comparative period SG&A was \$7.5 million. SG&A was elevated compared to the prior year comparative period, primarily as a result of increased corporate activity, compensation expenses related to the successful sale of Dresden and increased commissions in the Security Paper Products Segment as a result of higher sales in the segment.

Stock-based compensation expense was \$0.6 million during the period compared to \$0.7 million in the second quarter of 2013. The prior year comparative period stock-based compensation was \$2.0 million. Stock compensation was higher in the prior year comparative due to executive and management awards made under the Company's long-term incentive plan.

Selected Financial Information and Statistics

(thousands of dollars, except shipments, unaudited)	Q3 2013	Q2 2013	Q3 2012
Sales from continuing operations	53,160	59,883	38,257
EBITDA from continuing operations ⁽¹⁾	(7,290)	(8,356)	(14,876)
EBITDA ^{(2) (3)}	(7,290)	(4,934)	(6,559)
Net loss from continuing operations	(13,427)	(20,851)	(24,051)
Net (loss) income ⁽³⁾	(12,436)	134,125	(19,061)
Adjusted net loss from continuing operations ⁽⁴⁾	(15,573)	(20,632)	(23,239)
Paper shipments (tonnes) ⁽⁵⁾	1,856	1,953	1,207
Pulp shipments (ADMT)	31,258	38,006	30,561

⁽¹⁾ See Net Loss to EBITDA Reconciliation for Continuing Operations.

⁽²⁾ See Net (Loss) Income 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)	Q3 2013	Q2 2013	Q3 2012
Net loss	(13,427)	(20,851)	(24,051)
Foreign exchange loss (gain)	739	(534)	812
(Gain) loss on sale of property, plant and equipment	(4,135)	753	-
Legal provision	1,250	-	-
Adjusted net loss	(15,573)	(20,632)	(23,239)
Basic and diluted net loss per share	(0.92)	(1.43)	(1.67)
Adjusted net loss per share, basic and diluted	(1.07)	(1.42)	(1.61)

Net Loss to EBITDA Reconciliation for Continuing Operations:

(thousands of dollars, unaudited)	Q3 2013	Q2 2013	Q3 2012
Net loss	(13,427)	(20,851)	(24,051)
Income tax	(611)	3,392	(3,390)
Foreign exchange loss (gain)	739	(534)	812
Net finance expense	4,021	3,944	4,227
Amortization	4,296	4,281	4,203
(Gain) loss on sale of property, plant and equipment	(4,135)	753	-
Legal provision	1,250	-	-
Dispute resolution accrual	-	-	1,346
Stock based compensation	577	659	1,977
EBITDA	(7,290)	(8,356)	(14,876)

Net (Loss) Income to EBITDA Reconciliation Including Discontinued Operations:

(thousands of dollars, unaudited)	Q3 2013	Q2 2013	Q3 2012
Net (loss) income	(12,436)	134,125	(19,061)
Income tax	(611)	3,951	(1,386)
Foreign exchange loss (gain)	739	(534)	834
Net finance expense	4,021	5,105	4,600
Amortization	4,296	4,281	5,131
Gain on disposal of business	(991)	(153,274)	-
(Gain) loss on sale of property, plant and equipment	(4,135)	753	-
Legal provision	1,250	-	-
Dispute resolution accrual	-	-	1,346
Stock based compensation	577	659	1,977
EBITDA	(7,290)	(4,934)	(6,559)

Operating Results by Business Segment

Dissolving Pulp Segment

(thousands of dollars, except for shipments, unaudited)	Q3 2013	Q2 2013	Q3 2012
Sales	23,227	29,343	25,561
Operating loss	(8,982)	(8,828)	(10,314)
Shipments (ADMT)	31,258	38,006	30,561

During the third quarter of 2013, the FSC mill implemented a plan to reduce logistics, transportation and distribution costs. As a result, there was an increase in the dissolving pulp finished goods inventory, due to the mill retaining ownership of the dissolving pulp for a longer period in the sales cycle. Inventory levels of dissolving pulp were also higher at the end of the third quarter of 2013 due to ongoing negotiations with Chinese buyers on pricing levels in the event of any potential dumping tariffs for in-transit inventory. As a consequence sales and shipments in the third quarter of 2013 were significantly lower compared to the second quarter of 2013. At September 30, 2013, the mill held finished goods inventory consisting of 8,461 tonnes of dissolving pulp and 2,389 tonnes of NBHK. The mill did not hold material amounts of dissolving pulp at the end of either comparative period. Included in the operating loss of the third quarter of 2013 is inventory fair market valuation allowances of \$1.7 million.

Early in the second quarter of 2013, the FSC mill had its planned ten day maintenance shut-down. The maintenance shut-down negatively impacted operating results by approximately \$2.6 million. 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.

Towards the end of the third quarter and through October of 2013, the FSC mill completed successful testing on its ability to operate as a “swing mill”. The FSC mill is now capable of shifting production between dissolving pulp and NBHK to maximize margins in response to changing market conditions. The NBHK pulp inventory on hand at September 30, 2013 is a result of the initial test trials for operation as a “swing mill”.

Subsequent to the quarter end, dissolving pulp sales have resumed with our existing customers. In addition, subsequent to the quarter end, the Company successfully completed the mandatory grid test for its cogeneration facility and is now delivering power to the Hydro Québec grid at the contracted commercial rate. The Company expects to derive significant production cost savings at the FSC mill as a result, beginning in the fourth quarter of 2013.

Security Paper Products Segment

(thousands of dollars, except for shipments, unaudited)	Q3 2013	Q2 2013	Q3 2012
Sales	29,933	30,540	12,696
Operating loss	(1,569)	(1,392)	(9,028)
Shipments (tonnes)	1,856	1,953	1,207

Excluding a legal provision accrual of \$1.3 million relating to operations from prior years, the adjusted operating loss for the third quarter of 2013 was \$0.3 million, which is comparable to the results in the second quarter of 2013. Compared to the third quarter of 2012, the third and second quarters of 2013 reflect higher sales volumes and a better product mix.

Security paper production includes banknotes which result in varying degrees of costs and margin depending on the complexity of the features included. Despite the higher sales, less than favourable conditions in the prior year, such as the strength of the Swiss franc against the Euro, overcapacity in the banknote paper industry and increased competition for orders, continue to adversely impact results.

The Company continues to assess other strategic options at the Landqart mill. In the third and second quarters of 2013, non-core land sales resulted in proceeds of \$5.4 million and a realized gain of \$4.1 million, and proceeds of \$0.2 million and a realized loss of \$0.8 million, respectively. The gain and loss are not included in EBITDA or operating loss.

Fortress Optical Features Ltd. ("Fortress Optical") generated sales of \$0.7 million in the third quarter of 2013 and \$0.8 million in the second quarter of 2013. In the third quarter of 2012, \$0.4 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)	Q3 2013	Q2 2013	Q3 2012
Sales	-	15,628	34,695
Operating income	-	3,422	7,389
Shipments (tonnes)	-	6,055	13,994

The Dresden mill results for the month of April are reflected in the second quarter 2013 results. The Dresden mill was sold on April 30, 2013.

Nine Months Ended September 30

Selected Financial Information and Statistics for the Nine Months Ended:

(thousands of dollars, except for shipments, unaudited)	September 30, 2013	September 30, 2012
Sales from continuing operations	170,602	105,176
EBITDA from continuing operations ⁽¹⁾	(28,808)	(34,543)
EBITDA ^{(2) (3)}	(14,850)	(6,370)
Net loss from continuing operations	(53,092)	(32,422)
Net income (loss) ⁽³⁾	109,316	(17,442)
Adjusted net loss from continuing operations ⁽⁴⁾	(56,823)	(47,729)
Paper shipments (tonnes) ⁽⁵⁾	5,988	2,969
Pulp shipments (ADMT)	108,530	101,922

⁽¹⁾ See Net Loss to EBITDA Reconciliation for Continuing Operations.

⁽²⁾ See Net Income (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)	September 30, 2013	September 30, 2012
Net loss	(53,092)	(32,422)
Foreign exchange loss	261	1,375
Gain on sale of property, plant and equipment	(5,242)	(19,297)
Long-term debt prepayment penalty	-	2,615
Legal provision	1,250	-
Adjusted net loss	(56,823)	(47,729)
Basic and diluted net loss per share	(3.65)	(2.26)
Adjusted net loss per share, basic and diluted	(3.91)	(3.33)

Net Loss to EBITDA Reconciliation for Continuing Operations:

(thousands of dollars, unaudited)	September 30, 2013	September 30, 2012
Net loss	(53,092)	(32,422)
Income tax	966	(7,660)
Foreign exchange loss	261	1,375
Net finance expense	11,974	7,776
Amortization	12,911	11,453
Gain on sale of property, plant and equipment	(5,242)	(19,297)
Legal provision	1,250	-
Dispute resolution accrual	-	1,346
Stock based compensation	2,164	2,886
EBITDA	(28,808)	(34,543)

Net Income (Loss) to EBITDA Reconciliation Including Discontinued Operations:

(thousands of dollars, unaudited)

	September 30, 2013	September 30, 2012
Net income	109,316	(17,442)
Income tax	4,484	(1,068)
Foreign exchange (gain) loss	285	1,438
Net finance expense	13,502	11,719
Amortization	13,656	14,048
Gain on disposal of business	(154,265)	-
Gain (loss) on sale of property, plant and equipment	(5,242)	(19,297)
Legal provision	1,250	-
Dispute resolution accrual	-	1,346
Stock based compensation	2,164	2,886
EBITDA	(14,850)	(6,370)

Overview

EBITDA loss for the Company from continuing operations was \$28.8 million for the nine months ended September 30, 2013 on sales of \$170.6 million compared to \$34.5 million in the nine months ended September 30, 2012 on sales of \$105.2 million. The FSC mill experienced some challenges in first nine months of 2013 including depressed dissolving pulp prices, operational issues and some escalation in costs and timing delays on the cogeneration facility.

The Security Paper Products Segment generated significantly improved results in the first nine months of 2013 (\$0.1 million EBITDA) compared to the prior year (\$17.5 million EBITDA loss). The Dissolving Pulp Segment generated an EBITDA loss of approximately \$21.7 million in the first nine months of 2013 compared to \$12.2 million EBITDA loss in the prior year comparative period. Corporate costs contributed to EBITDA loss in the amount of \$7.2 million and \$4.8 million in the nine months ended September 30, 2013 and 2012, respectively.

Adjusted net loss for the nine month period ended September 30, 2013 was \$56.8 million or \$3.91 per share basic and diluted. Adjusted net loss for the prior comparative period was \$47.7 million or \$3.33 per share basic and diluted.

Cost of products sold was \$168.8 million for the nine months ended September 30, 2013 compared to \$118.5 million in the nine months ended September 30, 2012. In the prior year comparative period, cost of products sold as well as sales were impacted downward as a result of the capitalization of sales and cost of sales at the FSC mill for the period from January 1, 2012 through March 18, 2012. Both sales and cost of sales for the nine months ended September 30, 2013 increased as a result of the increased volume in the Security Paper Products Segment attributable in part to the reinstatement of a significant banknote order late in the prior year comparative period.

SG&A was elevated compared to the prior comparative periods, primarily as a result of increased corporate activity, bonus accruals related to the successful sale of the Dresden mill and higher commissions in the Security Paper Products segment as a result of increased sales in the segment. SG&A was \$31.9 million compared to \$22.6 million in the periods ended September 30, 2013 and 2012, respectively.

Stock based compensation was \$2.2 million in the nine months ended September 30, 2013 compared to \$2.9 million in the previous comparative period. Stock based compensation was higher in the prior year comparative due to executive and management awards made under the Company's long term incentive plan.

Foreign exchange gains and losses relate primarily to translation losses or gains on foreign denominated debt.

Operating Results by Business Segment

Dissolving Pulp Segment

(thousands of dollars, except for shipments, unaudited)	Nine Months Ended	
	September 30, 2013	September 30, 2012
Sales	81,456	71,093
Operating loss	(28,735)	(17,827)
Shipments (ADMT)	108,530	101,922

Results for the first nine months of 2013 at the FSC mill were impacted by production challenges related to the digester, evaporator, other operational and maintenance issues and a planned ten day maintenance shut-down. Compounding the impact on results were significantly lower realized sales prices relative to the prior comparative period due to weakening market prices of dissolving pulp in China.

Results for the period ended September 30, 2012 reflected a continued ramp up period of dissolving pulp production. Commercial production for accounting purposes began on March 18, 2012, however, the equipment did not operate at its intended fully ramped up rate for the remainder of the year. Although the table above reflects shipments for the full period, sales and cost of sales were only included in operating results from March 18, 2012 onwards.

Security Paper Products Segment

(thousands of dollars, except for shipments, unaudited)	Nine Months Ended	
	September 30, 2013	September 30, 2012
Sales	89,146	34,083
Operating loss	(7,083)	(24,673)
Shipments (tonnes)	5,988	2,969

The nine month period ended September 30, 2013 shows a significant improvement compared to the prior year comparative period. Both volume shipped and sales have increased materially resulting in longer production runs, and therefore, more efficient operations. Results for the nine months ended September 30, 2012 were adversely affected by a significant banknote order that was delayed and was only reinstated towards the end of June. Production only began part way through July 2012, improving operating efficiency but at a slower rate than anticipated. The operating losses include a \$1.3 million legal provision and a \$1.3 million dispute resolution accrual in the nine months ended September 30, 2013 and 2012, respectively.

Discontinued Operations: Specialty Papers Segment

(thousands of dollars, except for shipments, unaudited)	Nine Months Ended	
	September 30, 2013	September 30, 2012
Sales	57,730	113,167
Operating income	13,211	25,578
Shipments (tonnes)	22,062	44,078

Results for the nine month period ended September 30, 2013 reflect the Dresden mill results to its sale date of April 30, 2013.

Selected Cash Flow Items

	Q3 2013	Q2 2013	Nine Months Ended September 30, 2013	Q3 2012	Nine Months Ended September 30, 2012
Cash used by operations before working capital changes	(9,934)	(4,907)	(20,453)	(9,657)	(12,951)
Non-cash working capital change	(16,081)	7,076	(7,377)	2,389	21,795
Cash provided (used by) operating activities	(26,015)	2,169	(27,830)	(7,288)	8,844
Cash (used) provided by financing activities	(3,319)	(73,051)	(61,187)	58,780	111,800
Cash generated (used) by investing activities	(6,165)	174,380	154,921	(9,647)	(58,883)
Change in cash position	(35,499)	103,498	65,904	41,865	61,761
Foreign exchange gain (loss) on cash and cash equivalents	2,147	2,981	5,410	(114)	(824)

Operating Activities

Fortress operates in a cyclical industry and its operating cash flows vary accordingly. Fortress' principal operating cash expenditures are for compensation and raw materials. Operating activities used cash of \$27.8 million and provided \$8.8 million in the nine months ended September 30, 2013 and 2012, respectively. Working capital is subject to cyclical operating needs, the timing of collection of receivables and the payment of payables and expenses.

Financing Activities

During the first nine months of 2013, financing activities used cash of \$61.2 million. During the period, the Dresden mill entered into two credit facilities in the aggregate amount of €15 million (approximately \$19.9 million) with Commerzbank AG. The new facilities were repaid, together with all other outstanding Dresden indebtedness (approximately \$70.3 million), as a condition of and concurrently with the closing of the sale of the Dresden mill. A prepayment penalty of \$1.2 million was paid in connection with the early repayment of all the Dresden indebtedness. In addition \$9.6 million in interest was paid on long term debt.

During the nine month period ended September 30, 2012, financing activities generated \$111.8 million. These included, among other things, a \$25 million convertible debenture financing as part of the financing initiatives related to the FGC mill conversion project and a convertible unsecured subordinated debenture prospectus offering for gross proceeds of \$69 million. Proceeds received from option exercises during the period were \$0.6 million. Cash was generated by drawing on the final principal installments excluding holdbacks on the Company's loan agreement with Investissement Québec in respect of the FSC mill project. In March 2012, the Company entered into a new €25 million credit facility with Commerzbank to repay the balance of an existing loan agreement with GE Capital Bank AG. A penalty of \$2.6 million was paid in connection with the early repayment of the GE indebtedness. Payments on indebtedness (apart from the GE repayment) and debt interest during the period used cash of \$5.8 million and \$5.0 million, respectively.

Investing Activities

Investing activities in the first nine months of 2013 and 2012 provided cash of \$154.9 million and used cash of \$ 58.9 million, respectively. The sale of Dresden resulted in cash proceeds of \$212.2 million which were offset by \$2.1 million of costs associated with the sale of Dresden, \$52.9 million in additions to property, plant and equipment primarily at the FSC mill and \$11.5 million in restricted cash. Restricted cash provides security for banknote contracts in the Security Paper Products Segment. Non-core asset sales at the Landqart mill provided cash of \$9.2 million.

Investing activities for the nine months ended September 30, 2012 used cash of \$58.9 million. The purchase of equipment and other capital expenditures at our mills used cash of \$82.8 million. Other uses of cash relate to \$8.8 million of

capitalized start-up costs and \$1.2 million of restricted cash. Cash used in investing activities for the period ended September 30, 2012 was positively impacted by the \$19.4 million sale of non-core hydropower assets at Landqart as well as \$14.5 million received from government tax credits at the FSC mill.

Liquidity and Capital Resources

As at September 30, 2013, the Company had cash and cash equivalents balance of \$102.8 million and had made aggregate expenditures of approximately \$243 million, including \$2.3 million in accounts payable, on the conversion of FSC mill into a dissolving pulp mill and the construction of a new cogeneration facility. In the latter part of the first quarter of 2012, management reassessed the cogeneration project and identified certain deficiencies in a previous estimate from an engineering firm as well as scope of work adjustments necessary in order to commence delivery of power early in 2013. Additional costs were incurred as a result of repairs required to the recovery boiler during the third quarter of 2012. Subsequent to the 2012 year end, the Company announced that commissioning and start-up activities relating to the cogeneration project at the FSC mill had incurred delays as a result of various factors, including unforeseen piping related delays, reduced manpower availability, minor scope of work adjustments and, most recently, pump complications. As of the date of this MD&A, both the conversion project and the cogeneration project at the FSC mill have been completed.

Although there can be no assurances, Fortress believes that current cash (including proceeds from the divestiture of Dresden), cash generated from operations and proceeds from the divestiture of 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 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 and foreign currency exchange rates and the results of the MOFCOM investigation. Fortress may determine, in its sole discretion, that market or financial conditions may warrant that it seek additional sources of capital on terms satisfactory to Fortress, including but not limited to additional debt or equity financing, in order to fund capital expenditures, provide additional working capital, enhance liquidity or for other general corporate purposes. See "Risks and Uncertainties" in the Company's Management's Discussion and Analysis for the year ended December 31, 2012, available on SEDAR at www.sedar.com.

At September 30, 2013, the Company had aggregate indebtedness of \$227 million and net working capital of \$141.4 million.

Commitments

As at September 30, 2013 the Company has:

- committed to purchase \$1.5 million in property, plant, and equipment; and
- performance bonds in the amounts of EUR 7.3 million and CHF 0.1 million.

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

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

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

(thousands of dollars, unaudited)

	September 30, 2013	December 31, 2012
Cash and cash equivalents	102,805	31,491
Less total debt	226,972	255,901
Net debt	(124,167)	(224,410)
Shareholders' equity	356,528	229,669

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 quarter ended September 30, 2013.

Outstanding Shares

The number of common shares outstanding at September 30, 2013 and the date of this report were 14,561,417. The number of options outstanding at September 30, 2013 and the date of this report were 650,725. At September 30, 2013 and the date of this report there were 246,365 outstanding restricted share units. At September 30, 2013 and the date of this report there were 158,130 and 160,212 deferred share units outstanding, respectively.

Related Party Transactions

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

Contingencies

Provisions for liabilities relating to legal actions and claims require judgments using management's best estimates regarding projected outcomes and the range of loss, based on such factors as historical experiences and recommendations of legal counsel. Actual results may vary from estimates and the differences are recorded when known. A legal provision of \$1.3 million was recorded in the third quarter of 2013 that related to sales from the prior year.

Critical Accounting Estimates

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

New Accounting Pronouncements

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

Risks and Uncertainties

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

Disclosure Controls and Internal Controls over Financial Reporting

During the quarter ended September 30, 2013, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Canadian dollars, amounts in thousands, unaudited)

		September 30, 2013	December 31, 2012
Note		\$	\$
ASSETS			
Current			
Cash and cash equivalents		102,805	31,491
Restricted cash		14,205	2,600
Trade accounts receivable		19,996	13,835
Other accounts receivable	4	8,854	28,403
Inventories		43,263	53,064
Prepaid expenses	7	8,912	8,334
		198,035	137,727
Property, plant and equipment		439,516	440,227
Employee future benefits		2,132	–
		639,683	577,954
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities		43,701	79,806
Income taxes payable		–	3,123
Current portion of long-term debt	7	12,957	7,761
		56,658	90,690
Long-term debt	7	214,015	248,140
Provisions and other long term liabilities		7,029	5,528
Deferred income taxes		5,453	2,154
Employee future benefits	3	–	1,773
		283,155	348,285
Shareholders' equity			
Share capital	8	179,056	178,052
Contributed surplus		27,459	26,078
Retained earnings	3	136,315	23,387
Accumulated other comprehensive income	3	13,698	2,152
		356,528	229,669
		639,683	577,954

Subsequent event

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(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)

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Note	\$	\$	\$	\$
Sales	53,160	38,257	170,602	105,176
Costs and expenses				
Cost of products sold	(49,533)	(47,007)	(168,769)	(118,450)
Amortization	(4,296)	(4,203)	(12,911)	(11,453)
Selling, general and administration	(12,167)	(7,472)	(31,891)	(22,615)
Stock-based compensation	(577)	(1,977)	(2,164)	(2,886)
Operating loss	(13,413)	(22,402)	(45,133)	(50,228)
Other income (expense)				
Finance expense	(4,123)	(4,432)	(12,160)	(7,995)
Finance income	102	205	186	219
Gain on sale of property, plant and equipment	6 4,135	–	5,242	19,297
Foreign exchange loss	(739)	(812)	(261)	(1,375)
Net loss from continuing operations before income taxes	(14,038)	(27,441)	(52,126)	(40,082)
Income tax recovery (expense)	611	3,390	(966)	7,660
Net loss from continuing operations	(13,427)	(24,051)	(53,092)	(32,422)
Net income from discontinued operations	5 991	4,990	162,408	14,980
Net (loss) income	(12,436)	(19,061)	109,316	(17,442)
Loss and diluted loss per share from continuing operations	(0.92)	(1.67)	(3.65)	(2.26)
(Loss) earnings per share and diluted (loss) earnings per share	10 (0.85)	(1.32)	7.52	(1.22)
Weighted average number of shares outstanding				
Basic	14,561,417	14,394,359	14,533,482	14,341,025
Diluted	10 14,561,417	14,394,359	14,533,482	14,341,025

(See accompanying notes)

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

(Canadian dollars, amounts in thousands, unaudited)

	Three Months Ended September 30, 2013 \$	Three Months Ended September 30, 2012 \$	Nine Months Ended September 30, 2013 \$	Nine Months Ended September 30, 2012 \$
Net (loss) income	(12,436)	(19,061)	109,316	(17,442)
Other comprehensive income (loss)				
Items that may be reclassified subsequently to net income				
Exchange differences on translation of foreign operations	3,576	(2,100)	11,546	(2,916)
Items that will not be reclassified to net income				
Actuarial gain (loss) recognized on employee future benefits (net of taxes of (\$142), \$244, (\$723) and \$194)	711	(1,217)	3,612	(967)
Total other comprehensive income (loss)	4,287	(3,317)	15,158	(3,883)
Total comprehensive (loss) income	(8,149)	(22,378)	124,474	(21,325)

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Canadian dollars, amounts in thousands, unaudited)

	Note	Nine Months Ended September 30, 2013 \$	Nine Months Ended September 30, 2012 \$
Share Capital			
	8		
Balance at beginning of period		178,052	175,200
Restricted share units vested		635	1,980
Deferred share units vested		369	–
Options exercised		–	839
Balance at end of period		<u>179,056</u>	<u>178,019</u>
Contributed Surplus			
Balance at beginning of period		26,078	13,010
Stock based compensation		2,164	2,886
Early vesting of restricted share units on sale of division		221	–
Restricted share units vested		(635)	(1,980)
Deferred share units vested		(369)	–
Options exercised		–	(231)
Issuance of convertible note		–	7,388
Warrants		–	4,620
Balance at end of period		<u>27,459</u>	<u>25,693</u>
Retained Earnings			
Balance at beginning of period, as reported		23,039	40,741
Effect of retroactive adoption of new accounting pronouncement	3	348	340
Balance at beginning of period, restated		<u>23,387</u>	<u>41,081</u>
Net income		109,316	(17,442)
Defined benefit plan actuarial gain, net of tax		3,612	(967)
Balance at end of period		<u>136,315</u>	<u>22,672</u>
Accumulated Other Comprehensive Income			
Balance at beginning of period		2,152	2,688
Cumulative translation adjustment on foreign operations		11,546	(2,916)
Balance at end of period		<u>13,698</u>	<u>(228)</u>
Total equity		<u>356,528</u>	<u>226,156</u>

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Canadian dollars, amounts in thousands, unaudited)

	Note	Nine Months Ended September 30, 2013 \$	Nine Months Ended September 30, 2012 \$
Cash flows from (used by) operating activities			
Net income for the period		109,316	(17,442)
Adjustments:			
Gain on disposal of business	5	(154,265)	–
Gain on sale of property, plant and equipment	6	(5,242)	(19,297)
Amortization		13,656	14,048
Income tax expense		4,525	(1,066)
Income taxes paid		(2,720)	(5,506)
Foreign exchange gain		(1,575)	1,473
Finance expense		13,688	11,953
Stock-based compensation		2,164	2,886
		<u>(20,453)</u>	<u>(12,951)</u>
Change in non-cash working capital items			
Accounts receivable		7,219	5,091
Inventories		(2,221)	10,089
Prepaid expenses		(782)	(188)
Accounts payable and accrued liabilities and other		(11,593)	6,803
		<u>(27,830)</u>	<u>8,844</u>
Cash flows from (used by) financing activities			
Repayment of long-term debt		(52,306)	(31,969)
Proceeds from long-term debt		19,860	150,728
Options exercised		–	608
Repurchase of factored accounts receivable	5	(18,006)	–
Long-term debt prepayment penalty	5	(1,166)	(2,615)
Payment of long-term debt interest		(9,569)	(4,952)
		<u>(61,187)</u>	<u>111,800</u>
Cash flows from (used by) investing activities			
Additions to property, plant and equipment		(52,867)	(82,837)
Proceeds from sale of business	5	212,240	–
Adjustments and costs associated with sale of business	5	(2,126)	–
Startup costs capitalized		–	(8,815)
Proceeds from sale of property, plant and equipment	6	9,182	19,413
Investment tax credits received		–	13,543
Proceeds from Green Transformation program		–	1,000
Restricted cash		(11,508)	(1,187)
		<u>154,921</u>	<u>(58,883)</u>
Increase in cash position		65,904	61,761
Foreign exchange gain (loss) on cash and cash equivalents		5,410	(824)
Cash and cash equivalents, beginning of year		31,491	22,897
Cash and cash equivalents, end of period		<u>102,805</u>	<u>83,834</u>

(See accompanying notes)

FORTRESS PAPER LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the three and nine month periods ended September 30, 2013 and 2012
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1. NATURE OF OPERATIONS

Fortress Paper Ltd. (the “Company” or “Fortress”) was incorporated on May 30, 2006 under the laws of the Province of British Columbia. The address of the Company’s registered office is 157 Chadwick Court – 2nd floor, North Vancouver, British Columbia, Canada V7M 3K2. From the date of incorporation to July 31, 2006, the Company was inactive. The Company's fiscal year-end is December 31. Fortress Paper operates internationally in three distinct business segments: dissolving pulp, specialty papers and security paper products. As of April 30, 2013, the entire specialty papers segment was sold by the Company (*Note 5*). The Company operates its dissolving pulp business at the Fortress Specialty Cellulose Mill located in Canada, which, subsequent to September 30, 2013 completed its expansion into the renewable energy generation sector with the construction and successful start-up of a cogeneration facility. Fortress Specialty Cellulose was converted into a dissolving pulp mill with ramp up production starting in December of 2011. Commercial production at Fortress Specialty Cellulose for accounting purposes, with the equipment operating as intended by management, began on March 18, 2012. Fortress Specialty Cellulose is still considered to be in ramp up mode working towards full capacity and operating efficiencies. The Company is also seeking to expand its dissolving pulp capacity with the acquisition of the Fortress Global Cellulose Mill located at Lebel-sur-Quévillon, Québec, which the Company intends to convert into a dissolving pulp mill and re-start the cogeneration facility. Up to April 30, 2013, the Company operated its specialty papers business at the Dresden Mill located in Germany, where it was a leading international producer of specialty non-woven wallpaper base products (*Note 5*). 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 Company has consistently applied the same accounting policies throughout all periods presented, as if these policies had always been in effect. The policies applied in these condensed interim consolidated financial statements are based on International Financial Reporting Standards (“IFRS”) issued and outstanding as of November 7, 2013, the date the Board of Directors approved the statements.

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

3. NEW ACCOUNTING PRONOUNCEMENTS

IAS 1 – Presentation of Financial Statements

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

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IAS 19 – Employee Benefits

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

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

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

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

	December 31, 2012	January 1, 2012
<i>Adjustments to the statement of financial position</i>	\$	\$
Equity before accounting change	229,330	231,639
Decrease in employee future benefits liability	407	408
Increase in deferred income tax liability	(68)	(68)
Equity after accounting change	229,669	231,979
	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
<i>Adjustments to the statement of operations</i>	\$	\$
Net loss before accounting change	(18,900)	(16,932)
Increase in finance expense	(37)	(113)
Increase in selling, general and administrative expense	(156)	(498)
Decrease in deferred income tax expense	32	101
Net loss after accounting change	(19,061)	(17,442)

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	Three Months Ended September 30, 2012 \$	Nine Months Ended September 30, 2012 \$
<i>Adjustments to comprehensive income</i>		
Comprehensive income (loss) before accounting change	(22,354)	(21,445)
Increase in net loss	(161)	(510)
Increase in actuarial gain	152	651
Increase in exchange differences on translation of foreign operations	(15)	(21)
Comprehensive income (loss) after accounting change	(22,378)	(21,325)

New and Revised Standards Adopted with no Material Effect on Statements

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

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

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

IFRS 9 – Financial Instruments

In 2011, the IASB also amended IFRS 9 – *Financial Instruments*, which was originally planned to be effective for annual periods beginning on or after January 1, 2015. In July 2013, the IASB tentatively decided to defer the mandatory effective date of IFRS 9. The effective date is currently pending the finalization of the impairment and classification measurement requirements. The Company is still in the process of assessing the full impact of this standard. Further details on this standard can be found in the consolidated financial statements and notes as at and for the year ended December 31, 2012.

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4. OTHER ACCOUNTS RECEIVABLE

	September 30, 2013 \$	December 31, 2012 \$
Receivable from lender	800	4,052
Investment and other tax credits	627	468
Value added tax	3,916	6,668
Holdbacks	–	6,690
Receivable from supplier	–	6,241
Construction cost reimbursement	1,084	–
Government grant	1,037	1,194
Income tax	799	–
Other	591	3,090
	<u>8,854</u>	<u>28,403</u>

5. 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. Included in the gain is a net working capital adjustment of \$991 which was recorded during the three months ended September 30, 2013. 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.

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	<u>April 30, 2013 \$</u>
Book value of net assets disposed of:	
Restricted cash	531
Accounts receivable	26,832
Inventories	12,992
Prepaid expenses	210
Property, plant and equipment	31,553
Accounts payable and accrued liabilities	(16,723)
Income taxes payable	(3,932)
Deferred income tax liability	(373)
	<u>51,090</u>
Net assets disposed of	
Sale proceeds:	
Cash	212,240
Less: purchase price adjustments	(1,649)
Less: directly attributable costs	(2,416)
	<u>208,175</u>
Total net proceeds	
	<u>208,175</u>
Profit on disposal before recycling of cumulative translation adjustment	157,085
Cumulative translation adjustment	(2,820)
	<u>154,265</u>
Gain on disposal	<u>154,265</u>

The Dresden Mill represents the entire wallpaper segment of the Company. The results for the three and nine months ended September 30, 2013 and September 30, 2012 have been reclassified in the statement of operations as discontinued operations. The results of the discontinued operations are as follows:

	<u>Three Months Ended September 30, 2013 \$</u>	<u>Three Months Ended September 30, 2012 \$</u>	<u>Nine Months Ended September 30, 2013 \$</u>	<u>Nine Months Ended September 30, 2012 \$</u>
Income before income taxes and gain on disposal	–	6,994	11,661	21,572
Income taxes	–	(2,004)	(3,518)	(6,592)
Gain on disposal	991	–	154,265	–
	<u>991</u>	<u>4,990</u>	<u>162,408</u>	<u>14,980</u>
Net income from discontinued operations				
Cash flows from operating activities	–	3,182	8,494	12,657
Cash flows from financing activities	–	(2,136)	(49,231)	778
Cash flows from investing activities	–	(1,898)	(3,438)	(2,508)
	<u>–</u>	<u>(852)</u>	<u>(44,175)</u>	<u>10,927</u>
Increase in cash				

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6. PROPERTY, PLANT AND EQUIPMENT

During the three months ended September 30, 2013, the Company sold non-core assets at the Landqart mill for \$5,536. The carrying amount of the assets sold was \$1,401 with a resulting gain on the sale of \$4,135. During the six months ended June 30, 2013, the Company sold non-core land at the Landqart mill for \$3,800. The carrying amount of the assets sold was \$2,693 with a resulting net gain on the sale of \$1,108.

7. LONG-TERM DEBT

	September 30, 2013	December 31, 2012
Note	\$	\$
Credit facilities with lenders		
EUR nil, interest at 2.7%, maturing 2013, secured by certain current assets	7(a) —	126
EUR nil, interest at 3.8%, maturing 2017, secured by certain property, plant and equipment	7(a) —	29,305
CHF nil, interest at 4.9%, maturing 2015, secured by certain property, plant and equipment	7(b) —	2,445
CHF 5,310, maturing 2020, unsecured	5,213	4,849
\$105,167, interest up to 5.5%, maturing 2020, secured by certain assets	105,007	104,523
Undrawn credit facility	7(c) —	—
Unsecured convertible debentures		
\$40,250, interest at 6.5%, maturing 2016	35,570	34,695
\$25,000, interest at 7%, maturing 2017	22,883	22,548
\$69,000, interest at 7%, maturing 2019	58,299	57,410
	<u>226,972</u>	<u>255,901</u>
Less: Current portion	(12,957)	(7,761)
Long-term debt	<u>214,015</u>	<u>248,140</u>

	September 30, 2013	December 31, 2012
	\$	\$
Principal value of debt	245,457	277,165
Unamortized borrowing costs and amounts allocated to equity for convertible debentures	<u>(18,485)</u>	<u>(21,264)</u>
Net amount recorded in liabilities	<u>226,972</u>	<u>255,901</u>

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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 September 30, 2013, the fair value of the long-term debt, measured at its amortized cost of \$226,972 was \$206,326. The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

- (a) These credit facilities were repaid on April 30, 2013, concurrent with the disposal of the Dresden Mill (*Note 5*).
- (b) This credit facility was repaid during the three months ended September 30, 2013.
- (c) The credit agreement is a facility for up to \$132,400, granted to Fortress Global Cellulose to support the conversion to dissolving pulp expenditure program and is secured by the assets of Fortress Global Cellulose. The loan is repayable ten years after the first draw on the facility. At September 30, 2013, \$nil has been drawn on this facility. Borrowing costs of \$7,006 have been deferred and recorded as a prepaid expense until the loan is drawn upon. Included in the borrowing costs of the loan are 715,000 warrants which have been provided to the lender

8. SHARE CAPITAL

Authorized

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

Issued and fully paid — common shares

	Note	Number of Shares	Share Capital \$
Balance, December 31, 2011		14,303,594	175,200
Restricted Share Units vested	9	115,481	2,013
Options exercised	9	76,000	839
		14,495,075	178,052
Balance, December 31, 2012		14,495,075	178,052
Restricted Share Units vested	9	41,894	635
Deferred Share Units vested	9	24,448	369
		14,561,417	179,056
Balance, September 30, 2013			

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 September 30, 2013.

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9. STOCK-BASED COMPENSATION

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

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

Stock Options

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

	Number of options	Weighted Average Exercise Price \$
Balance, December 31, 2011	566,725	8.00
Exercised	(76,000)	8.00
Granted	300,000	15.41
Cancellation	(100,000)	8.00
Balance, December 31, 2012	690,725	11.22
Forfeited	(40,000)	15.41
Balance, September 30, 2013	650,725	10.96

During the nine months ended September 30, 2013, 40,000 unvested options were forfeited when an employee left the Company.

As at September 30, 2013, 650,725 stock options were exercisable (December 31, 2012: 590,725). The stock options issued have various vesting dates that range from immediately to five years from the grant dates.

Deferred Share Unit Awards

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

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

	Number of DSUs	Expense recognized \$
Balance, December 31, 2011	142,873	5,642
Granted	6,797	163
Balance, December 31, 2012	149,670	5,805
Granted	32,908	277
Vested	(24,448)	—
Balance, September 30, 2013	158,130	6,082

Restricted Share Unit Awards

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

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

	Number of RSUs
Balance, December 31, 2011	262,664
Granted	60,869
Vested	(115,481)
Forfeited	(6,850)
Balance, December 31, 2012	201,202
Granted	87,057
Vested	(41,894)
Balance, September 30, 2013	246,365

10. EARNINGS PER SHARE

The weighted average diluted number of shares is based on continuing operations. The weighted average diluted number of shares for comparative periods in 2012 differs from numbers previously reported due to items no longer being dilutive when based solely on continuing operations.

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11. COMMITMENTS

As at September 30, 2013, the Company has committed to purchase \$1,464 in property, plant, and equipment.

The Company regularly issues performance bonds to certain customers. As at September 30, 2013, the Company has performance bonds in the amounts of EUR 7,295 and CHF 51.

12. SEGMENTED INFORMATION

The segmentation of the Company's manufacturing operations is based on a number of factors, including production and economic characteristics. Fortress' business segments were re-classified in 2012 given changes in the nature of products being produced. The Landqart mill and Fortress Optical Features produce security papers and products. The Dresden mill produces non-woven wallpaper base products. The entire wallpaper division has been classified as discontinued operations (*Note 5*). Fortress Specialty Cellulose produces dissolving pulp products. For the nine months ended September 30, 2012, the Dissolving Pulp segment operating results up to March 18, 2012 were capitalized to property, plant and equipment during the startup period for dissolving pulp.

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	Three months ended September 30, 2013			
	Security	Pulp	Corporate	Fortress Paper Consolidated
	\$	\$	\$	\$
Sales	29,933	23,227	–	53,160
Operating loss	(1,569)	(8,982)	(2,862)	(13,413)
Amortization ¹	(1,947)	(2,349)	–	(4,296)
Stock-based compensation ¹	–	–	(577)	(577)
Capital expenditures	615	7,693	–	8,308
Total assets	133,082	391,309	115,292	639,683

Sales by geographic area	%
Europe	20.4
Asia	69.9
Other	9.7
Total	100.0

¹Stock-based compensation and amortization are included in operating loss.

	Three months ended September 30, 2012					
	Security	Pulp	Corporate	Continuing Operations	Discontinued Operations (Wallpaper)	Fortress Paper Consolidated
	\$	\$	\$	\$	\$	\$
Sales	12,696	25,561	–	38,257	34,695	72,952
Operating income (loss)	(9,028)	(10,314)	(3,060)	(22,402)	7,389	(15,013)
Amortization ¹	(1,905)	(2,298)	–	(4,203)	(928)	(5,131)
Stock-based compensation ¹	–	–	(1,977)	(1,977)	–	(1,977)
Capital expenditures	326	28,182	–	28,508	1,948	30,456
Total assets	133,890	351,769	30,596	516,255	67,165	583,420

Sales by geographic area	%	%	%
Europe	13.2	98.2	53.6
Asia	86.4	–	45.3
Other	0.4	1.8	1.1
Total	100.0	100.0	100.0

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

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	Nine months ended September 30, 2013					
	Security	Pulp	Corporate	Continuing Operations	Discontinued Operations (Wallpaper)	Fortress Paper Consolidated
	\$	\$	\$	\$	\$	\$
Sales	89,146	81,456	–	170,602	57,730	228,332
Operating income (loss)	(7,083)	(28,735)	(9,315)	(45,133)	13,211	(31,922)
Amortization ¹	(5,864)	(7,047)	–	(12,911)	(745)	(13,656)
Stock-based compensation ¹	–	–	(2,164)	(2,164)	–	(2,164)
Capital expenditures	1,617	40,670	–	42,287	3,652	45,940
Total assets	133,082	391,309	115,292	639,683	–	639,683

Sales by geographic area

	%	%	%
Europe	9.1	96.6	31.5
Asia	79.8	3.1	60.2
Other	11.1	0.3	8.3
Total	100.0	100.0	100.0

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

	Nine months ended September 30, 2012					
	Security	Pulp	Corporate	Continuing Operations	Discontinued Operations (Wallpaper)	Fortress Paper Consolidated
	\$	\$	\$	\$	\$	\$
Sales	34,083	71,093	–	105,176	113,167	218,343
Operating income (loss)	(24,673)	(17,827)	(7,728)	(50,228)	25,578	(24,650)
Amortization ¹	(5,815)	(5,638)	–	(11,453)	(2,595)	(14,048)
Stock-based compensation ¹	–	–	(2,886)	(2,886)	–	(2,886)
Capital expenditures	1,150	70,384	–	71,534	3,206	74,740
Total assets	133,890	351,769	30,596	516,255	67,165	583,420

Sales by geographic area

	%	%	%
Europe	15.0	97.6	57.8
Asia	77.5	2.1	38.4
Other	7.5	0.3	3.8
Total	100.0	100.0	100.0

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the three and nine month periods ended September 30, 2013 and 2012
(Canadian dollars, amounts in thousands except share and per share data, unaudited)

13. SUBSEQUENT EVENT

In February 2013, China's Ministry of Commerce ("MOFCOM") announced the commencement of an anti-dumping investigation on the importing of cellulose pulp originating from Canada, the United States and Brazil, after receiving a petition from certain manufacturers in China. The announcement included Fortress Specialty Cellulose Ltd. ("Fortress Specialty") as one of the Canadian producers that is subject to the investigation. Fortress Specialty registered with MOFCOM the same month and submitted its responses to MOFCOM.

On November 6, 2013, the Company announced that MOFCOM made a preliminary determination to impose an interim duty on the import of dissolving pulp into China from each of the originating countries. The interim duty applied against Fortress Specialty's dissolving pulp imports has been calculated at 13% of the CIF price to China, and will be payable in cash bonds in respect of prospective imports during the period between MOFCOM's preliminary and final determination.

The Company is evaluating its legal options to reverse the preliminary decision of MOFCOM. Fortress Specialty will initially have 10 days to submit a response to MOFCOM's preliminary determination. The Company is also preparing further submissions to be made to MOFCOM prior to its final determination and is reviewing the possibility of requesting a public hearing.

Although Fortress Paper believes that it has strong arguments against the imposition of a dumping duty, there is no assurance that it will be successful in reversing MOFCOM's preliminary determination or in securing the Canadian Government's support in commencing a WTO review. If the Company is not successful in reversing MOFCOM's preliminary determination, there may be an impact on the carrying value of the Company's dissolving pulp assets.