FORTRESS PAPER LTD.

Q4 2008

FOR THE THREE MONTHS AND YEAR ENDED

DECEMBER 31, 2008

FORTRESS PAPER LTD.
MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations of Fortress Paper Ltd. ("Fortress" or the "Company") has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and should be read in conjunction with the unaudited consolidated financial statements and the notes thereto for the year ended December 31, 2008 (available on SEDAR at www.sedar.com). The MD&A provides a review of the significant developments that have impacted the Company's performance during the quarter ended December 31, 2008 relative to the previous quarter and prior year comparative quarter, and the year ended December 31, 2008 relative to the year ended December 31, 2007.

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

Throughout this discussion, reference is made to EBITDA (defined as net income before interest, income taxes, depreciation, amortization, non-operating income and expenses and stock based compensation), which the Company considers to be an indicative measure of operating performance and a good metric to evaluate profitability. EBITDA is not a generally accepted earnings measure and should not be considered as an alternative to net income or cash flows as determined in accordance with GAAP. As there is no standardized method of calculating EBITDA, the Company's use of the term may not be directly comparable with similarly titled measures used by other companies. A reconciliation of EBITDA to net income reported in accordance with GAAP is included in this MD&A.

The information in this report is as at March 3, 2009.

All financial references are in Canadian dollars unless otherwise noted.

Highlights

Fortress reported net income of $2.8 million for the fourth quarter of 2008 on sales of $46.3 million or basic and diluted earnings per share of $0.27. For the fourth quarter of 2007 the Company reported net income of $2.3 million on sales of $37.5 million or basic and diluted earnings per share of $0.22. In the third quarter of 2008 the Company reported net income of $2.3 million on sales of $43.7 million or basic and diluted earnings per share of $0.22.

Included in net income for the fourth quarter of 2008 was a foreign exchange loss of $0.1 million. Included in net income for the third quarter of 2008 and the fourth quarter of 2007 were foreign exchange losses of $1.3 million and $0.1 million, respectively.

For the year ended December 31, 2008, Fortress Paper recorded net income of $12.7 million on sales of $189.0 million. For the year ended December 31, 2007, the Company recorded net income of $5.3 million on sales of $145.3 million. Net income for the years ended December 31, 2008 and 2007 included foreign exchange losses of $0.6 million $0.4 million, respectively.

EBITDA was $6.0 million or 13.2% of sales for the three months ended December 31, 2008. For the three months ended December 31, 2007 EBITDA was $4.3 million or 11.3% of sales.

EBITDA was $25.0 million or 13.2% of sales for the year ended December 31, 2008 compared to $13.6 million or 9.4% of sales for the year ended December 31, 2007.

The increase in EBITDA relative to the prior year comparative period was primarily due to capacity increases at both our mills and the continued shift towards higher margin products, particularly more non-woven wallpaper base at the Dresden mill.

Description of Business

The Company was incorporated on May 30, 2006 under the laws of the Province of British Columbia. Fortress Paper Ltd. is an international producer of security and other specialty papers. The Company owns and operates two paper mills, the Landqart Mill located in Switzerland and the Dresden Mill located in Germany. Fortress' security papers include banknote, passport and visa papers. The security papers produced at the Landqart Mill incorporate internationally recognized overt and covert security features which are embedded into the paper and supplemented with customer-specific features. The Landqart Mill has leveraged its extensive security papers competence to develop additional commercial applications using its in-house know-how and technology of security features to create innovative paper-based security products. Fortress' specialty papers business includes non-woven wallpaper base products, as well as graphic and technical papers. The Dresden Mill produces coated and uncoated wallpaper base for wallpaper manufacturers.

The Company completed its initial public offering ("IPO") on June 28, 2007 by the issuance of 5 million common shares at an offering price of $8.00 per share for total proceeds of $40 million. The shares commenced trading on the Toronto Stock Exchange on June 28, 2007 under the symbol "FTP". In July 2007, pursuant to an underwriting agreement between the Company and the underwriters, in connection with the initial public offering of the Company, the underwriters exercised their option to purchase an additional 750,000 common shares of the Company at a price of $8.00 per share, bringing the total gross proceeds from the IPO to $46 million.

Fourth Quarter 2008 Earnings Review

Three Months Ended December 31, 2008

Selected Financial Information and Statistics

(thousands of dollars, except per unit amounts and shipments, unaudited)	Q4 2008	Q3 2008	Q4 2007
Sales	46,331	43,744	37,537
EBITDA[1]	5,966	6,234	4,255
Operating income	4,399	4,993	3,380
Net income	2,778	2,312	2,279
Shipments (tonnes)	11,528	12,843	13,247

[1]See net income to EBITDA reconciliation.

Operating Results by Business Segment

Landqart Mill

(thousands of dollars, except for shipments, unaudited)	Q4 2008	Q3 2008	Q4 2007
Sales	23,628	19,080	17,072
Operating income	1,244	1,195	1,715
Shipments (tonnes)	4,338	4,286	4,138

Dresden Mill

(thousands of dollars, except for shipments, unaudited)	**Q4 2008**	**Q3 2008**	**Q4 2007**
Sales	22,703	24,664	20,465
Operating income	4,156	4,874	2,556
Shipments (tonnes)	6,911	8,557	9,109

Overview

Sales. Sales for the three months ended December 31, 2008 were significantly higher relative to fourth quarter of 2007 primarily due to capacity increases at both our mills which were largely completed in the third quarter of 2007 and the continued shift towards higher margin products, particularly more non-woven wallpaper base at the Dresden mill. Sales for the three months ended December 31, 2008 were slightly lower when compared to the previous quarter due mainly to decrease in demand at our Dresden location based on the developments in the global economy.

Landqart produces various security and specialty papers. Security paper production includes banknotes which result in varying degrees of EBITDA margin depending on the complexity of the features included.

Cost of Products Sold. Cost of products sold were $35.0 million or 75.6% of sales for the three months ended December 31, 2008 compared to $28.1 million or 74.9% in the prior year comparative period. In the third quarter of 2008, cost of products sold were $31.6 million or 72.3% of sales. Other than for a shut down over the holiday period, the mills operated at full capacity during the respective periods**.**

Selling, General and Administrative. Selling, general and administrative expenses were $5.3 million (fourth quarter 2007, $5.2 million and third quarter 2008, $5.9 million) and were comprised primarily of sales commissions, marketing, corporate and administrative expenses.

Stock-based Compensation. Stock-based compensation expense was $0.3 million during the period ($0.3 million and $0.4 million in the fourth quarter of 2007 and the third quarter of 2008, respectively) reflecting the grant of 982,675 options issued to directors and officers of the Company in fiscal 2007 and 30,000 issued to an employee in January 2008.

EBITDA. As a result of the foregoing factors, EBITDA was $6.0 million in the fourth quarter of 2008 compared to $4.3 million in the fourth quarter of 2007 and $6.2 million in the third quarter of 2008.

Net income to EBITDA reconciliation:

(thousands of dollars, unaudited)	**Q4 2008**	**Q3 2008**	**Q4 2007**
Net income	2,778	2,312	2,279
Income tax	1,353	1,382	906
Other expense (income)	113	1,257	58
Interest expense	155	42	137
Amortization	1,307	865	588
Stock based compensation	260	376	287
EBITDA	$5,966	$6,234	$4,255

Year Ended December 31, 2008

Selected Financial Information and Statistics for the Years Ended:

(thousands of dollars, except for shipments, unaudited)	**December 31, 2008**	**December 31, 2007**
Sales	189,002	145,294
EBITDA[1]	25,027	13,611
Operating income	19,994	10,598
Net income	12,680	5,284
Shipments (tonnes)	53,221	52,093

[1]See net income to EBITDA reconciliation.

Operating Results by Business Segment

Landqart Mill

(thousands of dollars, except for shipments, unaudited)	**December 31, 2008**	**December 31, 2007**
Sales	83,432	63,281
Operating income	4,011	3,569
Shipments (tonnes)	17,700	16,268

Dresden Mill

(thousands of dollars, except for shipments, unaudited)	**December 31, 2008**	**December 31, 2007**
Sales	105,570	82,013
Operating income	20,007	9,614
Shipments (tonnes)	35,521	35,825

Overview

Sales. Sales for the year ended December 31, 2008 were significantly higher relative to prior year comparative period primarily due to capacity increases at both our mills and the continued shift towards higher margin products, particularly more non-woven wallpaper base at the Dresden mill.

Landqart produces various security and specialty papers. Security paper production includes banknotes which result in varying degrees of EBITDA margin depending on the complexity of the features included. During 2008 Landqart also started producing non-woven wallpaper base. Included in Landqart's sales number for the year ended December 31, 2008 is approximately 732 tonnes in non-woven wallpaper base.

Cost of Products Sold. Cost of products sold were $141.9 million or 75.1% of sales for the year ended December 31, 2008. In the year ended December 31, 2007 cost of products sold were $113.4 million or 78.1% of sales. Other than for shut downs in the third quarter for capital upgrades, and during the holidays in December, the mills operated at full capacity during the respective periods. Increased input costs have been more than offset by improved efficiencies including less waste.

Selling, General and Administrative. Selling, general and administrative expenses were $22.0 million for the year ended December 31, 2008 and $18.3 million in the prior year comparative period. This increase is reflective of the higher level of sales activity.

Stock-based Compensation. Stock-based compensation expense was $1.4 million during the period (prior year comparative period, $0.9 million) reflecting the grant of 982,675 options issued to directors and officers of the Company in fiscal 2007 and 30,000 issued to an employee in January 2008.

EBITDA. As a result of the foregoing factors, EBITDA was $25.0 million for the year ended December 31, 2008 compared to $13.6 for the year ended December 31, 2007.

Net income to EBITDA reconciliation:

(thousands of dollars, unaudited)	**December 31, 2008**	**December 31, 2007**
Net income	12,680	5,284
Income tax	5,382	3,585
Other (income) expense	597	436
Interest expense	1,335	1,293
Amortization	3,645	2,105
Stock based compensation	1,388	908
EBITDA	$25,027	$13,611

Liquidity and Capital Resources

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

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

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

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

	December 31, 2008	December 31, 2007
Cash and cash equivalents	$ 26,187	$ 45,307
Less total debt	(30,591)	(34,466)
Net (debt) cash	$ (4,404)	$ 10,841
Shareholders' equity	$ 72,904	$ 69,868

The Company is not subject to any externally imposed capital requirements.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Financial instruments that potentially subject the Company to credit risk include cash and cash equivalents and accounts receivable.

Cash and cash equivalents includes cash on deposit with an original maturity date of 90 days or less. In order to mitigate the risk of financial loss, cash on deposit is held with major Canadian and international financial institutions. The cash and cash equivalents balance at December 31, 2008 was $26.2 million (December 31, 2007 - $45.3 million). The Company does not have holdings in asset backed commercial paper.

The Company utilizes a combination of credit insurance and factoring to manage the risk associated with trade receivables. Approximately 90% of the outstanding trade receivables are covered under credit insurance. The majority of the balance is with large and financially sound customers. Accounts receivable aged greater than 90 days is $0.7 million and is considered collectable. The Company's trade receivable balance at December 31, 2008 was $18.1 million (December 31, 2007 - $11.8 million).

Operating Activities

Fortress operates in a cyclical industry and its operating cash flows vary accordingly. Fortress' principal operating cash expenditures are for compensation, fibre, chemicals and debt service. Operating activities generated cash of $7.8 million in the year ended December 31, 2008 compared to $6.4 million in the year ended December 31, 2007.

Working capital is subject to cyclical operating needs, the timing of collection of receivables and the payment of payables and expenses. During the year there were extreme fluctuations in the CHF/CAD and Euro/CAD exchange rates which exaggerated the actual changes in non-cash working capital amounts shown as adjustments to operating activities in the cash flow statement for 2008. The CHF/CAD and Euro/CAD exchange rates were 1.1472 and 1.7046 respectively as at December 31, 2008 compared to a CHF/CAD rate of 0.8720 and a Euro/CAD rate of 1.4428 as at December 31, 2007.

Foreign currency translation in 2008 has distorted movements in working capital items. The largest impact was on inventory, trade receivables, debt and accounts payable and accrued liabilities. Inventory increased by $8.2 million of which $4.1 million was attributable to foreign exchange. Trade receivables increased by $6.3 million of which $3.0 million was a result of foreign exchange. Debt decreased by $3.9 million which includes a loss of $7.0 million for foreign exchange. Without the effect of foreign exchange, debt decreased by $10.9 million. Accounts payable and accrued liabilities increased by $1.1 million which includes a loss of $5.1 million for foreign exchange. Without the effect of foreign exchange, accounts payable and accrued liabilities decreased by $4.0 million.

Investing Activities

Investing activities in the year ended December 31, 2008 used cash of $16.4 million related to the purchase of plant and equipment at the mills. In the year ended December 31, 2007 investing activities used cash of $11.3 million, $14.3 million related to the purchase of plant and equipment at the mills which was partially offset by the release of restricted cash of $2.9 million.

During January of 2008, the Company received 6,500,000 shares of iDcentrix for licensing of LQard exclusive rights for the United States and Mexico and non-exclusive rights for other countries. Concurrent with this transaction, iDcentrix became a public company. The fair value of the shares initially recorded as an increase in other income was determined to be $560. During the quarter ended March 31, 2008, the Company recognized other expense of $257 for previously unrecorded equity losses relating to 2007 and $303 for equity losses relating to 2008 bringing the value of the investment to $ nil. As at December 31, 2008 there are unrecognized equity losses in excess of the fair value initially recorded. The Company is under no obligation to fund these losses

The shares of iDcentrix closed at $0.24 per share at December 31, 2008. The shares held by the Company are subject to certain trading restrictions.

Financing Activities

Financing activities in the year ended December 31, 2008 used cash of $12.8 million primarily related to the redemption of the convertible note ($8.2 million), repayment of debt and operating loans ($9.8 million), and share repurchases ($0.7 million) partially offset by $5.9 million in additional financing. In the year ended December 31, 2007, financing activities provided cash of $43.6 million primarily related to the $41.4 million initial public offering funds received net of issuance costs which were partially offset by the net decrease in debt of $2.2 million.

Early Redemption of Convertible Debt

During the quarter ended June 30, 2008, the terms of the convertible debt were amended to allow for redemption by the Company prior to August 1, 2009. On May 22, 2008, the Company redeemed the convertible debt in full. The Company paid $8,176, representing the full principal amount of the Convertible Note together with the interest accrued up to August 1, 2009, and 105,000 common shares of the Company. On May 22, 2008 the shares of the Company were trading at $10.74. Of the $9,304 total consideration provided to Mercer, $951 was recorded as interest expense and $742 was recorded as a decrease in retained earnings. The amounts recorded as equity and interest expense were determined using methodology consistent with the original valuation of the components of the Convertible Note. The expense portion was calculated using the present value of future cash outflows using a 5% discount rate.

Related Party Transactions

In the year ended December 31, 2008, the Company, in the normal course of business, has paid office and administration expenses of $38 (2007 - $90) to a company with a common director.

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Foreign Currency

The Company is exposed to foreign exchange risk primarily in Euros and Swiss Francs. The Company's products are sold globally with prices denominated primarily in Euros and Swiss Francs. The majority of the Company's expenditures are denominated in Euros and Swiss Francs. In addition the Company holds financial assets and liabilities in the local operating currencies.

Sensitivity analysis:

The Company has completed a sensitivity analysis to estimate the impact on net income for the period which a change in foreign exchange rates during the year ended December 31, 2008 would have had.

This sensitivity analysis includes the following assumptions:

- Changes in individual foreign exchange rates do not cause foreign exchange in other countries to alter
- Changes in market interest rates to do not cause a change in foreign exchange rates

The results of the foreign exchange sensitivity analysis can be seen in the following table:

	Impact on net income		
Change of +/- 1% in CHF foreign exchange rate	+/-	$	79
Change of +/- 1% in Euro foreign exchange rate	+/-	$	302

The above results arise due to the combined impact of foreign currency translation of the balance sheet and the effect of foreign exchange fluctuations on operations. The currency risk is partially mitigated by both revenues and expenses being denominated in local currencies.

Limitations of sensitivity analysis

The financial position of the Company may vary at the time that a change in the factors occurs, causing the impact on the Company's results to differ from that shown above

Outstanding Shares

The number of common shares outstanding at December 31, 2008 and the date of this report was 10,233,500. The number of options outstanding at December 31, 2008 and the date of this report was 1,012,675.

Critical Accounting Estimates

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

Changes in Accounting Policies

Effective January 1, 2008, the Company adopted the Canadian Institute of Chartered Accountants' new Handbook Sections; 1535 "Capital Disclosures", 3031 "Inventories", 3862 "Financial Instruments – Disclosures" and 3863 "Financial Instruments – Presentation". Handbook Sections 3862 and 3863 replace Section 3861 "Financial Instruments – Disclosure and Presentation". These recommendations have been incorporated into the unaudited interim consolidated financial statements.

Section 1535 – Capital Disclosures

This Section establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard the Company is required to disclose qualitative and quantitative information that enables users of the financial statements to evaluate the Company's objectives, policies and processes for managing capital (see note 7 to the interim consolidated financial statements).

Section 3031 – Inventories

This Section replaces Section 3030 and prescribes the accounting treatment for inventories and provides guidance on the determination of costs and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on assigning costs to inventories and in conjunction with Section 3061 "Property Plant and Equipment", provides guidance on classification of major spare parts. The adoption of this Section did not have a significant impact on the Company.

Section 3862 – Financial Instruments – Disclosures

This Section requires entities to provide disclosure of quantitative and qualitative information in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and management's objectives, policies and procedures for managing such risks (see note 19 to the consolidated financial statements).

Section 3863 – Financial Instruments – Presentation

This Section establishes standards for presentation of financial instruments and non-financial derivatives.

International financial reporting standards (IFRS)

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011 and will be applicable to the Company commencing with its fiscal year beginning January 1, 2011. The transition date of January 1, 2011 for the Company will require the restatement for comparative purposes of amounts reported by the Company for the year ended June 30, 2011. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

Internal Controls Over Financial Reporting

Based on current securities legislation in Canada, the Chief Executive Officer and the Chief Financial Officer of the Company are required to certify that they have:

- designed the Company's disclosure controls and procedures, or caused them to be designed under their supervision;
- designed the Company's internal control over financial reporting, or caused it to be designed under their supervision; and
- evaluated the effectiveness of the Company's disclosure controls and procedures and the Company's internal control over financial reporting as of December 31, 2008.

During 2008, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting. An evaluation was performed under the supervision and with the participation of the Company's management including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures and the Company's internal control over financial reporting as of December 31, 2008. In addition, independent testing of the effectiveness of the Company's internal control over financial reporting as of December 31, 2008 was performed. Based on that evaluation, the Company's management concluded that the Company's disclosure controls and procedures and the Company's internal control over financial reporting were effective as of December 31, 2008.

Management's Outlook

The market for security papers was strong throughout 2008 and continues to show strength. The wallpaper base market experienced a decline in orders late in 2008 as a direct result of the financial and economic situation impacting the global economies. After showing signs of weakness at the end of 2008, orders have been steadily improving. The Company has a very strong balance sheet and continues to selectively evaluate both organic opportunities to further increase capacity and external acquisitions to take advantage of strong industry fundamentals for our portfolio of products, with a particular focus on security papers.

Risks and Uncertainties

A comprehensive discussion of Risk Factors is included in the Company's 2007 annual information form available on SEDAR at www.sedar.com.

Selected Quarterly Information

(thousands of dollars, except per unit amounts, earnings per share ("EPS"), exchange rates and shares outstanding, unaudited)	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Sales	46,331	43,744	49,138	49,789
Operating income	4,399	4,993	5,075	5,527
EBITDA	5,966	6,234	6,184	6,643
Net income	2,778	2,312	3,401	4,189
Basic EPS	$0.27	$0.22	$0.33	$0.41
Diluted EPS	$0.27	$0.22	$0.33	$0.38
Weighted average shares outstanding Basic (thousands)	10,235	10,302	10,248	10,203
Weighted average shares outstanding Diluted (thousands)	10,235	10,471	10,423	11,141
Average Swiss/Canadian exchange rate(1)	1.0470	0.9699	0.9797	0.9405
Average Euro/Canadian exchange rate (1)	1.5960	1.5623	1.5778	1.5046

(thousands of dollars, except per unit amounts, earnings per share ("EPS"), exchange rates and shares outstanding, unaudited)	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Sales	37,537	34,065	35,441	38,251
Operating income	3,380	1,406	3,364	2,448
EBITDA	4,255	2,196	4,319	2,841
Net income	2,279	211	1,700	1,094
Basic EPS	$0.22	$0.02	$0.40	$0.35
Diluted EPS	$0.22	$0.02	$0.38	$0.20
Weighted average shares outstanding Basic (thousands)	10,204	10,049	4,275	3,102
Weighted average shares outstanding Diluted (thousands)	11,141	10,986	5,212	6,227
Average Swiss/Canadian exchange rate(1)	0.8563	0.8720	0.8982	0.9501
Average Euro/Canadian exchange rate (1)	1.4213	1.4370	1.4801	1.5355

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

Fortress Paper Ltd.

Consolidated Financial Statements
December 31, 2008 and 2007

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Auditors' Report

To the Shareholders of
Fortress Paper Ltd.

We have audited the consolidated balance sheets of **Fortress Paper Ltd.** as at December 31, 2008 and 2007 and the consolidated statements of operations and comprehensive income and retained earnings (deficit), and cash flows for each of the years in each of the two year period ended December 31, 2008. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for each of the years in each of the two year period ended December 31, 2008 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Vancouver, BC
March 3, 2009

FORTRESS PAPER LTD.
CONSOLIDATED BALANCE SHEETS

As at December 31
(Canadian dollars, amounts in thousands)

	2008	2007
ASSETS		
Current		
Cash and cash equivalents	$ 26,187	$ 45,307
Trade accounts receivable	18,108	11,778
Other accounts receivable	3,846	2,899
Inventories *(note 5)*	31,968	23,808
Prepaid expenses	373	420
	80,482	84,212
Restricted cash	49	44
Property, plant and equipment *(note 7)*	43,536	30,626
Employee future benefits *(note 14)*	11,574	8,303
Total assets	$ 135,641	$ 123,185
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Operating loans *(note 8)*	$ –	$ 5,854
Accounts payable and accrued liabilities	24,502	23,356
Income taxes payable	5,455	3,241
Current portion of long-term debt *(note 8)*	6,831	4,813
	36,788	37,264
Long-term debt *(note 8)*	23,760	23,799
Future income taxes *(note 16)*	2,187	2,408
Total liabilities	$ 62,735	$ 63,471
Shareholders' equity *(note 9)*		
Share capital	59,083	58,428
Contributed surplus	2,107	1,508
Retained earnings (deficit)	11,716	(222)
Total shareholders' equity	72,906	59,714
Total liabilities and shareholders' equity	$ 135,641	$ 123,185

Commitments and contingencies *(note 13)*

(See accompanying notes)

Approved by the Board of Directors:

"Chadwick Wasilenkoff" — Director

"Richard Whittall" — Director

FORTRESS PAPER LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME AND RETAINED EARNINGS (DEFICIT)

Year ended December 31
(Canadian dollars, amounts in thousands)

	2008	2007
Sales	$ 189,002	$ 145,294
Costs and expenses		
Cost of products sold	141,949	113,409
Amortization	3,645	2,105
Selling, general and administration	22,026	18,274
Stock-based compensation *(note 9 and 10)*	1,388	908
Operating income (loss)	19,994	10,598
Other income (expense)		
Interest, net *(note 15)*	(1,335)	(1,293)
Foreign exchange (loss)	(597)	(436)
Net Income before income taxes	18,062	8,869
Income tax expense *(note 16)*	(5,382)	(3,585)
Net income and comprehensive income	$ 12,680	$ 5,284
Earnings per share		
Basic and diluted	$ 1.24	$ 0.76
Weighted average number of shares outstanding		
Basic and diluted	10,249,286	6,935,337

	2008	2007
Retained earnings (deficit)		
Balance — beginning of period	$ (222)	$ (5,506)
Redemption of Convertible Note *(note 8)*	(742)	–
Earnings	12,680	5,284
Balance — end of period	$ 11,716	$ (222)
Accumulated other comprehensive earnings		
Balance — beginning and end of period	$ –	$ –

(See accompanying notes)

FORTRESS PAPER LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ending December 31
(Canadian dollars, amounts in thousands)

	2008	2007
Cash flows from operating activities		
Net income	$ 12,680	$ 5,284
Items not affecting cash:		
Amortization	3,645	2,105
Future income taxes	(221)	34
Foreign exchange (gain) loss on long term debt	6,842	(1,683)
Foreign exchange (gain) loss on operating loan	256	(371)
Foreign exchange (gain) loss on cash and cash equivalents	(2,328)	693
Stock based compensation	1,388	908
	22,262	6,970
Non-operating interest penalty *(note 8)*	950	–
Change in non-cash working capital items		
Trade accounts receivable	(7,277)	672
Inventory	(8,160)	(5,087)
Prepaid expenses	47	(171)
Other assets	(3,271)	(67)
Accounts payable and accrued liabilities	3,203	4,088
	7,754	6,405
Cash flows from financing activities		
Issuance of common shares, net of issue costs *(note 9)*	–	41,428
Redemption of Convertible Note, including penalties *(note 8)*	(8,176)	–
Repayment of long-term debt	(2,891)	(7,926)
Proceeds from long-term debt	5,941	12,389
Proceeds from (repayment of) operating loans	(6,109)	1,972
Shares repurchased *(note 9)*	(662)	–
Repayment of note payable *(note 8)*	–	(2,999)
Payment on capital leases	(877)	(1,248)
	(12,774)	43,616
Cash flows from investing activities		
Additions to property, plant and equipment	(16,423)	(14,269)
Restricted cash	(5)	2,928
	(16,428)	(11,341)
(Decrease) increase in cash position	(21,448)	38,680
Foreign exchange gain (loss) on cash and cash equivalents	2,328	(693)
Cash and cash equivalents, beginning of period	45,307	7,320
Cash and cash equivalents, end of period	$ 26,187	$ 45,307

Supplementary cash flow information *(note 18)*

(See accompanying notes)

1. NATURE OF OPERATIONS

Fortress Paper Ltd. (the "Company") was incorporated on May 30, 2006 under the laws of the Province of British Columbia. From the date of incorporation to July 31, 2006 the Company was inactive. The Company's fiscal year end is December 31.

The Company completed its initial public offering on June 28, 2007 by the issuance of 5,000,000 Common shares at an offering price of $8.00 per share for total proceeds of $40,000. The shares commenced trading on the Toronto Stock Exchange under the symbol “FTP”. On July 19, 2007, pursuant to an underwriting agreement between the Company and the Underwriters dated June 20, 2007, in connection with the initial public offering of the Company, the Underwriters exercised their option to purchase an additional 750,000 Common shares of the Company issued at a price of $8.00 per share, bringing the total gross proceeds from the initial public offering of Fortress Paper Ltd. to $46,000.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

All significant intercompany transactions and balances have been eliminated.

Revenue and Related Cost Recognition

The Company recognizes revenue from product sales when persuasive evidence of an arrangement exists, the sales price is fixed or determinable, title of ownership and risk of loss have passed to the customer and collectability is reasonably assured. Sales are reported net of discounts and allowances. Amounts charged to customers for shipping and handling are recognized as revenue. Shipping and handling costs incurred by the Company are included in cost of sales.

Estimates

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

Foreign Currency Translation

The mills are considered as integrated operations therefore all foreign currencies are translated into Canadian dollars using average rates for the period for items included in the consolidated statements of operations, the rate in effect at the balance sheet date for monetary assets and liabilities, and historical rates for other assets included in the consolidated balance sheet. Translation gains or losses are included in the determination of income.

Cash and Cash Equivalents

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

Inventories

Finished goods and work in process inventories are valued at the lower of average cost and net realizable value. Raw materials and supplies inventory are valued at the lower of average cost and net realizable value.

Property, Plant and Equipment

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

No amortization is charged on major improvements or expansions until construction is completed. Betterments and replacements, including leasehold and other improvements that extend the assets' useful life or productive capabilities of major units of property and equipment are capitalized. Maintenance, repairs and minor replacements are expensed as incurred. The Company does not capitalize interest incurred for construction in progress.

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

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

Impairment of long-lived assets

The Company reviews property, plant, and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability is assessed by comparing the carrying amount to the projected future net undiscounted cash flows the long-lived assets are expected to generate. If an impairment is identified the asset is written down to fair value which would be based on discounted future cash flows.

Employee future benefits

The Company accrues for its obligations under employee benefit plans and the related costs net of plan assets.

The Company has adopted the following policies:

- The measurement date used for accounting purposes is December 31;

- The cost of pensions earned by employees is actuarially determined using the projected benefit method pro-rated on service and management's estimate of expected plan investment performance, salary escalation and retirement ages of employees;

- For the purpose of calculating the expected return on plan assets, those assets are valued at fair value;

- The excess of the net actuarial gain (loss) over 10% of the greater of the benefit obligations and the fair value of plan assets is amortized over the average remaining service period of the active employees which is 8.9 years (2007 – 8.9 years)

Income taxes

Future income taxes are provided for using the liability method. Under the liability method, future income taxes are recognised for temporary differences between the tax and financial statement bases of assets, liabilities and certain carry-forward items.

Future income tax assets are recognised only to the extent that it is more likely than not that they will be realised. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of substantive enactment.

Earnings per share

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

In the period ended December 31 2007, the stock options, performance options and share awards, as disclosed in note 10, were not included in the computation of loss per share as their inclusion would be anti-dilutive.

Stock-based compensation

The Company has a stock option plan as described in note 10. The Company uses the Black-Scholes Option Pricing Model to estimate the fair value of each stock option at the date of the initial public offering ("IPO date") or grant date for options granted post IPO date. The value of stock options granted to directors and officers is recorded as stock-based compensation and credited to contributed surplus over the relevant vesting period. Any consideration received on the exercise of stock options is credited to share capital and the appropriate original fair value is reallocated from contributed surplus to share capital.

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

3. CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2008, the Company adopted the Canadian Institute of Chartered Accountants' new Handbook Sections; 1535 "Capital Disclosures", 3031 "Inventories", 3862 "Financial Instruments – Disclosures" and 3863 "Financial Instruments – Presentation". Handbook Sections 3862 and 3863 replace Section 3861 "Financial Instruments – Disclosure and Presentation". These recommendations have been incorporated into these unaudited interim consolidated financial statements.

Section 1535 – Capital Disclosures

This Section establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard the Company is required to disclose qualitative and quantitative information that enables users of the financial statements to evaluate the Company's objectives, policies and processes for managing capital (note 11).

Section 3031 – Inventories

This Section replaces Section 3030 and prescribes the accounting treatment for inventories and provides guidance on the determination of costs and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on assigning costs to inventories and in conjunction with Section 3061 "Property Plant and Equipment", provides guidance on classification of major spare parts. The adoption of this Section did not have a significant impact on the Company.

Section 3862 – Financial Instruments – Disclosures

This Section requires entities to provide disclosure of quantitative and qualitative information in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and management's objectives, policies and procedures for managing such risks (note 19).

Section 3863 – Financial Instruments – Presentation

This Section establishes standards for presentation of financial instruments and non-financial derivatives.

4. NEW ACCOUNTING PRONOUNCEMENTS

In February 2008, the CICA issued a new accounting standard, Handbook Section 3064, Goodwill and Intangible Assets. This section replaces CICA Handbook Section 3062, Goodwill and Intangible Assets, and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of various preproduction and start-up costs and requires that these costs be expensed as incurred. This standard will be applicable to the Company for annual and interim accounting periods beginning on January 1, 2009. The Company does not expect that this standard will have a material impact on its consolidated financial statements.

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

In 2007, the Canadian Accounting Standards Board announced that Canadian generally accepted accounting principles ("Canadian GAAP") will cease to exist for all publicly accountable enterprises targeted for fiscal years commencing January 1, 2011. From that date onward, publicly traded companies and certain other publicly accountable enterprises will be required to report under International Financial Reporting Standards ("IFRS"). The impact of the transition to IFRS on the Company's consolidated financial statements has not yet been determined.

In January 2009, the CICA issued three new standards which may affect the financial disclosures and results of operations of the Company for interim and annual periods beginning January 1, 2011 with earlier adoption permitted. CICA Handbook Section 1582, "Business Combinations", is effective for business combinations taking place after this section is adopted. CICA Handbook Section 1601, "Consolidated Financial Statements", and CICA Handbook Section 1602, "Non-controlling Interests", must be adopted at the same time as Section 1582. These Sections replace the former CICA Handbook Section 1581, "Business Combinations" and CICA Handbook Section 1600, "Consolidated Financial Statements", and establish a new Section for accounting for non-controlling interests in a subsidiary. The Company is still considering the impact of these new standards and when they will be adopted.

5. INVENTORIES

	2008	2007
Raw materials	$ 17,018	$ 13,000
Work in progress	869	952
Finished goods	14,081	9,856
	$ 31,968	$ 23,808

6. INVESTMENTS

During the year ended December 31, 2007, the Company received 3,500,000 shares of a private company, namely iDcentrix Inc. ("iDcentrix"), for licensing of LQard Canadian rights. The initial fair value of the shares was determined to be $Nil. The Company is deemed to exert significant influence over iDcentrix through its share ownership and accounts for its investment in iDcentrix using the equity method.

During the year ended December 31, 2008, the Company received 6,500,000 shares of iDcentrix for licensing of LQard exclusive rights for the United States and Mexico and non-exclusive rights for other countries. Concurrent with this transaction, iDcentrix became a public company. The fair value of the shares initially recorded as an increase in other income was determined to be $560. The Company recognized $257 as other expenses for previously unrecorded equity losses relating to 2007. The Company also recognized $303 as other expenses for equity losses relating to 2008. There are currently unrecognized equity losses relating to the year ended December 31, 2008. The Company is under no obligation to fund these losses.

The shares of iDcentrix closed at $0.26 per share at December 31, 2008. The shares held by the Company are subject to certain trading restrictions.

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

7. PROPERTY, PLANT AND EQUIPMENT

	2008		
	Cost	Accumulated Amortization	Net Book Value
Land and building	$ 6,161	$ 282	$ 5,879
Production and other equipment	30,679	6,323	24,356
Construction-in-progress	13,301	–	13,301
	$ 50,141	$ 6,605	$ 43,536

	2007		
	Cost	Accumulated Amortization	Net Book Value
Land and building	$ 5,837	$ 189	$ 5,648
Production and other equipment	21,942	2,771	19,171
Construction-in-progress	5,807	—	5,807
	$ 33,586	$ 2,960	$ 30,626

The net book value and accumulated amortization of capital leases included in production and other equipment was $1,066 and $660 respectively at December 31, 2008 and $1,402 and $287 respectively at December 31, 2007.

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

8. LONG-TERM DEBT AND OPERATING LOANS

Long-term debt

	2008	2007
Convertible debt due 2011; interest at prime +2% (a)	$ –	$ 7,500
Credit agreement with bank maturing 2009 and 2013; interest at 2.65% secured by current assets (EUR 962 and 1,346)	1,640	1,943
Credit agreement with bank maturing 2008, 2009, and 2011; interest at 4.5%, 3.8% and Libor + 2.5% secured by mortgage (CHF 3,950 and 4,350)	4,532	3,793
Credit agreement with bank maturing 2012; interest at 4.8% unsecured (CHF 6,280 and 7,850)	7,204	6,845
Credit agreement with bank maturing 2011, 2013 and 2018; interest up to 3.1% and 4.9% secured by fixed assets (CHF 14,244 and 8,566)	16,340	7,470
Capital leases; interest at 4.7% (CHF 19 and 629)	21	548
Capital leases; interest at 4.0% (EUR 501 and 678)	854	978
	30,591	29,077
Less: Convertible debt allocated to contributed surplus, net of accretion (a)	–	(465)
Less: Current portion	(6,831)	(4,813)
	$ 23,760	$ 23,799

Principal repayments as at December 31, 2008 are required as follows:

	Long term debt	Capital lease	Total
2009	$ 6,509	$ 322	$ 6,831
2010	4,910	302	5,212
2011	4,911	251	5,162
2012	4,498	—	4,498
2013	2,533	—	2,533
Thereafter	6,355	—	6,355
	$ 29,716	$ 875	$ 30,591

(a) The convertible debt ("Convertible Note") was a senior secured convertible note of the Company in the principal amount of $7,500 that matured in August, 2011. The Convertible Note bore interest at an annual rate equal to the prime rate of a national Canadian bank, plus 2%. The Convertible Note was secured by a first security lien upon all or substantially all of the Company's assets. The Convertible Note was redeemable by the Company on or after August 1, 2009, in whole or in part, at 100% of the principal amount to be redeemed together with interest accrued theron up to but not including the redemption date.

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

The Company had initially recorded a liability portion of $6,900 and an equity portion of $600 in contributed surplus. The liability portion has been calculated using present value of future cash outflows using a 10% discount rate.

During 2008 the terms of the Convertible Note were amended to allow for redemption by the Company prior to August 1, 2009. On May 22, 2008 the Company redeemed the Convertible Note in full. The Company paid $8,176, representing the full principal amount of the Convertible Note together with the interest accrued up to August 1, 2009, and 105,000 common shares of the Company. On May 22, 2008 the shares of the Company were trading at $10.74. Of the $9,304 total consideration provided, $951 was recorded as interest expense and $742 was recorded as a decrease in retained earnings. The amounts recorded as equity and interest expense were determined using methodology consistent with the original valuation of the components of the Convertible Note. The expense portion was calculated using the present value of future cash outflows using a 5% discount rate.

Operating loans

During the year ended December 31, 2008 the Company fully repaid and closed its operating loans.

9. SHAREHOLDERS' EQUITY

(a) **Authorized:**

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

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

	Number of Shares	Share Capital	Contributed Surplus
Balance, December 31, 2006	3,000,000	$ 12,000	$ 5,600
Private placements	203,500	814	—
Performance based compensation	1,250,000	5,000	(5,000)
Initial public offering	5,750,000	46,000	—
Share issue costs	—	(5,386)	—
Stock compensation	—	—	908
Balance, December 31, 2007	10,203,500	$ 58,428	$ 1,508
Stock compensation	—	—	1,388
Share repurchase	(75,000)	(473)	(189)
Shares issued on redemption of Convertible Note *(note 8)*	105,000	1,128	(600)
Balance, December 31, 2008	10,233,500	$ 59,083	$ 2,107

Share capital reorganization

Effective June 20, 2007, the Company consolidated its outstanding common shares on the basis of one new common share for every two existing common shares. The impact of the share capital consolidation has been reflected in these consolidated financial statements and the accompanying notes.

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

Private Placements

On July 19, 2007, pursuant to an underwriting agreement between the Company and the Underwriters dated June 20, 2007, entered into in connection with the initial public offering of the Company, the Underwriters exercised their option to purchase an additional 750,000 Common shares of the Company issued at a price of $8.00 per share, bringing the total gross proceeds from the initial public offering of Fortress Paper Ltd. to $46,000.

On June 28, 2007, the Company completed its initial public offering of 5,000,000 Common shares at an offering price of $8.00 per share for total proceeds of $40,000.

On February 22, 2007 the Company raised $400 by the issuance of 100,000 shares.

On February 6, 2007 the Company raised $414 by the issuance of 103,500 shares.

Share Repurchase

During the year ended December 31, 2008, the Company repurchased, and cancelled, 75,000 of its own common shares through a normal course issuer bid for a total cost of $662.

10. STOCK OPTIONS

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. The maximum number of options that may be granted must not exceed 10% of the common shares outstanding at the time of the grant.

On April 5, 2007 and May 2, 2007 two tranches of options were granted for 320,350 and 122,325 shares, respectively to directors and officers of the Company with an exercise price equivalent to the IPO price with an expiry 10 years from the IPO date (June 20, 2007). On November 1, 2007 a further two tranches of options were granted for 240,000 and 300,000 shares to directors of the Company with expiry 10 years from the grant date. On January 1, 2008 options were granted for 30,000 shares to an employee of the Company.

The stock options vest from one year to three years from the IPO or grant dates.

The Company recorded stock-based compensation expense of $1,388 during the year ended December 31, 2008 (2007 - $908)

The weighted average fair value of the options, being $3.09 per option, has been estimated at the grant dates using the Black-Scholes option pricing model. Option pricing models require the input of highly subjective assumptions including the expected volatility. Changes in the assumptions can materially affect the fair value estimate, and, therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options. Assumptions used in the pricing model are as follows:

Risk-free interest rate	4%
Expected life of options	5 years
Annualized volatility	40%
Dividend rate	Nil

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

The weighted average remaining expected life of the options at December 31, 2008 is 3.9 years.

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

	Number of options	Exercise Price
Granted April 5, 2007	320,350	$ 8.00
Granted May 2, 2007	122,325	8.00
Granted November 1, 2007	540,000	8.00
Balance, December 31, 2007	982,675	$ 8.00
Granted January 1, 2008	30,000	$ 8.00
Balance, December 31, 2008	1,012,675	$ 8.00

As at December 31, 2008, 535,117 stock options were exercisable (2007 – 147,558). No stock options were exercised in the year ended December 31, 2008.

11. CAPITAL DISCLOSURES

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

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

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

	December 31, 2008	December 31, 2007
Cash and cash equivalents	$ 26,187	$ 45,307
Less total debt	(30,591)	(34,466)
Net (debt) cash	$ (4,404)	$ 10,841
Shareholders' equity	$ 72,904	$ 69,868

The Company is not subject to any externally imposed capital requirements.

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

12. RELATED PARTY TRANSACTIONS

In the year ended December 31, 2008, the Company, in the normal course of business, has paid or accrued office and administration expenses of $38 to a Company with a common director (2007 - $90).

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

13. COMMITMENTS AND CONTINGENCIES

The minimum operating lease commitment over the next 5 years and thereafter is as follows:

	2008
2009	$ 615
2010	600
2011	432
2012	119
2013	84
Thereafter	–
	$ 1,850

During 2008, the Dresden Papier mill received state and federal grants totaling EUR 387. In previous years, the Dresden Papier mill had received state and federal grants totaling EUR 5,963. As of December 31, 2008 the Company has accrued EUR 91 as a repayment obligation under the terms of the grants for overpayments in prior years. There are no additional repayment obligations as of December 31, 2008.

The Company has provided guarantees of EUR 450 for the future purchase of equipment.

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

14. EMPLOYEE FUTURE BENEFITS

The Company maintains a defined benefit pension plan in Switzerland providing pension benefits based on either length of service or earnings and length of service. The Company measures its accrued benefit obligations and fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation for the plan was December 31, 2006.

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

	2008	2007
Accrued benefit obligation		
Beginning of period	$ 46,723	$ 49,664
Service cost	1,423	1,190
Interest cost on accrued obligation	1,730	1,375
Benefit payments	(1,576)	(302)
Contributions by plan participants	1,155	930
Actuarial gain	–	(1,763)
Foreign exchange	15,199	(4,371)
End of period	$ 64,654	$ 46,723
Plan assets		
Fair value, beginning of period	$ 55,992	$ 57,015
Actual return on plan assets	(8,154)	2,501
Employer contributions	1,169	928
Employee contributions	1,155	930
Benefit payments	(1,576)	(302)
Foreign exchange	16,444	(5,080)
End of period	$ 65,030	$ 55,992
Funded status — plan surplus	$ 378	$ 9,271
Unamortized net actuarial loss (gain)	11,196	(968)
Accrued benefit asset	$ 11,574	$ 8,303

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

	2008	2007
Expense		
Current service cost	$ 1,423	$ 1,190
Interest cost	1,730	1,375
Actual loss (return) on plan assets	8,154	(2,501)
Actual actuarial (gain) loss on benefit obligations	–	(1,763)
Expenses before adjustments	11,307	(1,699)
Difference between expected return and actual return on plan assets	(10,696)	(207)
Difference between net actuarial (gain) loss recognized and actual (gain) loss on benefit obligations	–	1,763
Net expense	$ 611	$ (143)
Significant actuarial assumptions used are as follows	%	%
Discount rate to determine benefit obligations at end of year	3.3	3.3
Discount rate to determine benefit expense (income) for the year	3.3	2.9
Expected rate of return on plan assets	4.0	4.0
Rate of increase in future compensation	1.5	1.5
Plan assets at fair value at the end of the year	%	%
Liquid assets	3.7	4.0
Bonds	56.8	55.0
Equity — World	19.0	22.0
Real estate	20.5	19.0
	100.0	100.0

15. INTEREST, NET

	2008	2007
Interest expense	$ (2,492)	$ (2,146)
Interest expense on capital lease	(62)	(61)
Interest income	1,219	914
	$ (1,335)	$ (1,293)

Interest expense for 2008 includes $951 in interest penalties related to the redemption of the Convertible Note.

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

16. INCOME TAXES

The components of the future income tax liability are as follows:

	2008	2007
Future income tax assets (liabilities)		
Pension benefit	$(2,187)	$(2,408)
Non-capital loss carryforward	4,045	3,788
Property, plant and equipment	2,257	4,098
Share issue costs	840	1,336
Investments	1,820	2,317
Other	(714)	(157)
	6,061	8,974
Valuation allowance	(8,248)	(11,382)
Net future income tax liability	$(2,187)	$(2,408)

Non-capital loss carryforward consist of approximately $11,793 from our Landqart operations which expire beginning in 2009 through 2015 and $6,188 from Corporate which expire beginning in 2026 through 2028.

The components of income tax expense are as follows:

	2008	2007
Current	$ (5,603)	$ (3,446)
Future	221	(139)
	$ (5,382)	$ (3,585)

The reconciliation of income taxes calculated at the statutory rate of 31.00% to the actual income tax provision is as follows:

	2008	2007
Net income (loss) before income taxes	$ 18,062	$ 8,869
Income tax (recovery) at statutory rates	5,599	3,026
Stock compensation and other non deductible expenses	344	214
Rate differentials between foreign jurisdictions, capital gains and future tax rates	2,221	535
Share issue costs	–	(1,838)
Tax loss carryforward expired (used)	351	499
Change in valuation allowance	(3,133)	1,149
Income tax expense	$ 5,382	$ 3,585

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

17. SEGMENTED INFORMATION

The segmentation of the Company's manufacturing operations by mill is based on a number of factors, including production, production processes, and economic characteristics. The accounting policies for each mill are the same as those described in note 2. Landqart produces specialty and security papers while Dresden Papier produces non-woven wallpaper base products. During the year ended December 31, 2008, the Company earned revenue from one customer of $30,282 representing 16.0% of sales. During the year ended December 31, 2007, the Company earned revenue from the same customer of $15,910 representing 10.9% of sales.

	2008			
	Dresden Papier (Germany)	**Landqart** (Switzerland)	**Corporate** (Canada)	**Fortress Paper Consolidated**
Sales	$ 105,570	83,432	—	$ 189,002
Operating earnings (loss)	$ 20,007	4,011	(4,024)	$ 19,994
Amortization	$ (1,836)	(1,809)	—	$ (3,645)
Stock-based compensation[1]	$ —	—	(1,388)	$ (1,388)
Capital expenditures	$ 7,983	8,572	—	$ 16,555
Property, plant and equipment	$ 16,653	26,883	—	$ 43,536
Sales by geographic area	%	%		%
Germany	52.1	15.0		35.7
Switzerland	—	23.5		10.4
Other Western Europe	25.2	40.6		32.0
Eastern Europe	21.1	10.2		16.3
Other	1.6	10.7		5.6
Total	100.0	100.0	—	100.0

[1]Stock-based compensation is included in operating earnings (loss)

	2007			
	Dresden Papier (Germany)	**Landqart** (Switzerland)	**Corporate** (Canada)	**Fortress Paper Consolidated**
Sales	$ 82,013	63,281	—	$ 145,294
Operating earnings (loss)	$ 9,614	3,569	(2,585)	$ 10,598
Amortization	$ (1,417)	(688)	—	$ (2,105)
Stock-based compensation[2]	$ —	—	(908)	$ (908)
Capital expenditures	$ 3,000	13,305	—	$ 16,305
Property, plant and equipment	$ 10,505	20,121	—	$ 30,626
Sales by geographic area	%	%		%
Germany	51.5	11.2		34.0
Switzerland	—	29.4		12.8
Other Western Europe	25.1	36.6		30.1
Eastern Europe	20.1	12.3		16.7
Other	3.3	10.5		6.4
Total	100.0	100.0	—	100.0

[2]Stock-based compensation is included in operating earnings (loss)

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

18. SUPPLEMENTARY CASH FLOW INFORMATION

Supplemental information		2008		2007
Interest paid	$	2,045	$	2,060
Income taxes paid	$	3,958	$	539

Non cash items

During the year ended December 31, 2008, the Company received 6,500,000 shares of iDcentrix for licensing of LQard North American rights.

During the year ended December 31, 2008, there were 105,000 common shares of the Company issued as part of the redemption of the Convertible Note.

Change in non cash property, plant and equipment purchases included in accounts payable were $131 at December 31, 2008 and $788 at December 31, 2007.

During the year ended December 31, 2007, the Company received 3,500,000 shares of iDcentrix for licensing of LQard Canadian rights.

19. FINANCIAL INSTRUMENTS

Classification of Financial Instruments

The Company has classified its cash and cash equivalents as held-for-trading and recorded at fair value. Accounts receivable are classified as loans and receivables and are measured at amortized cost. Accounts payable and accrued liabilities, other liabilities, operating loans, and long-term debt, including interest payable, are classified as other liabilities, all of which are measured at amortized cost. Derivative instruments are recorded in the balance sheet at fair value. The Company has no derivatives embedded in its financial or non-financial contracts that are not closely related to the host contract.

Financial Risk Management

The Company is exposed to a number of risks as a result of holding financial instruments. These risks include credit risk, liquidity risk and market risk.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Financial instruments that potentially subject the Company to credit risk include cash and cash equivalents and accounts receivable.

Cash and cash equivalents includes cash on deposit with an original maturity date of 90 days or less. In order to mitigate the risk of financial loss, cash on deposit is held with major Canadian and international financial institutions. The cash and cash equivalents balance at December 31, 2008 was $26.1 million (December 31, 2007 - $45.3 million). The Company does not have holdings in asset backed commercial paper.

The Company utilizes a combination of credit insurance and factoring to manage the risk associated with trade receivables. Approximately 90% of the outstanding trade receivables are covered under credit insurance. The majority of the balance is with large and financially sound customers. Accounts receivable aged greater than 90 days is \$0.7 million and is considered collectable. The Company's trade receivable balance at December 31, 2008 was \$18.1 million (December 31, 2007 - \$11.8 million).

Liquidity Risk

Liquidity risk is the risk that the Company will be unable to meet its financial obligations as they fall due. The Company manages liquidity risk through management of its capital structure in conjunction with cash flow forecasting including anticipated investing and financing activities.

At December 31, 2008, the Company's accounts payable and accrued liabilities totaled \$24.5 million (December 31, 2007 - \$23.4 million), all of which fall due for payment within one year of the balance sheet date.

The Company manages liquidity risk through ongoing review of accounts receivable balances and the management of its cash and debt positions.

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

Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates and foreign currency.

Interest rate risk:

The Company is exposed to interest rate risk through its financial assets and financial obligations bearing variable interest rate. The Company believes that interest rate fluctuations would not have a significant impact on net income.

The Company manages interest rate risk by maximizing the interest earned on excess funds while maintaining the liquidity necessary to meet day-to-day operating cash flow requirements.
The Company currently does not use derivative instruments to reduce its exposure to interest rate Risk.

Currency risk:

The Company is exposed to foreign exchange risk primarily in Euros, Swiss Francs, and Canadian dollars. The Company's products are sold globally with prices denominated primarily in Euros and Swiss Francs. The majority of the Company's expenditures are denominated in Euros and Swiss Francs. In addition the Company holds financial assets and liabilities in the local operating currencies.

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

For the year ended December 31, 2008, the Company used derivative instruments to reduce its exposure to currency risk for sales not denominated in a local currency.

Sensitivity analysis:

The Company has completed a sensitivity analysis to estimate the impact on net income for the period which a change in foreign exchange rates or interest rates during the year ended December 31, 2008 would have had.

This sensitivity analysis includes the following assumptions:

- Changes in individual foreign exchange rates do not cause foreign exchange in other countries to alter
- Changes in market interest rates to do not cause a change in foreign exchange rates

The results of the foreign exchange sensitivity analysis can be seen in the following table:

	Impact on net income	
Change of +/- 1% in CHF foreign exchange rate	+/-	$ 79
Change of +/- 1% in Euro foreign exchange rate	+/-	$ 302

The above results arise due to the combined impact of foreign currency translation of the balance sheet and the effect of foreign exchange fluctuations on operations. The currency risk is partially mitigated by both revenues and expenses being denominated in local currencies.

Limitations of sensitivity analysis

The financial position of the Company may vary at the time that a change in the factors occurs, causing the impact on the Company's results to differ from that shown above.

Derivative Instruments

During the year ended December 31, 2008, the Company used derivatives for foreign exchange rates to reduce the exposure for certain sales made outside of local currencies.

The Company has committed to buying a total of USD 1,500 over various dates between January, 2009 and June, 2009 at EUR/USD foreign exchange rates ranging from 1.4554 and 1.4644. The Company has recognized $88 in other income for the year ended December 31, 2008 as a result of recording these forward contracts at the year-end market value.

During 2008 the Company entered into a foreign exchange agreement with a customer to collar the exposure to fluctuations between the GBP and Euro. The resulting gains, including mark-to-market adjustment, recognized in other income in 2008 relating to this agreement totaled EUR 554. This agreement ended December 31, 2008.

There were no derivative instruments used during the year ended December 31, 2007.