FORTRESS PAPER LTD
Q2 2014

FOR THE THREE AND SIX MONTHS ENDED

JUNE 30, 2014

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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 August 5, 2014. The MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements and the notes thereto for the three and six month periods ended June 30, 2014 (available on SEDAR at www.sedar.com). This MD&A provides a review of the significant developments that have impacted the Company's performance during the quarter ended June 30, 2014 relative to the previous quarter and prior year comparative quarter. The financial information contained herein has been prepared in accordance with International Financial Reporting Standards ("IFRS"), including IAS 34, Interim Financial Reporting.

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

Assumptions underlying the Company's expectations regarding forward-looking information contained in this MD&A include, among others: that the Company will be able to effectively market its products; the ability of the Company to realize significant cost-savings from production improvements, cost reduction initiatives and the cogeneration facility at the Fortress Specialty Cellulose mill; that current depressed dissolving pulp prices are indicative of unusual market conditions and are not sustainable in the medium to long term; that demand for viscose staple fibre will continue to grow which will result in an increased demand for dissolving pulp; that the swing mill strategy at the Fortress Specialty Cellulose mill will assist in mitigating the adverse impacts resulting from the imposition of the dumping tariff on dissolving pulp exports into China; that the adverse impact of any dumping tariff will be limited to the short-term; that the Company will be able to successfully implement measures that will mitigate the impact of the final duty on dissolving pulp on its business; that the Landqart mill will continue operating on a consistent and regular basis in order to produce and deliver on its banknote orders; that the Landqart mill will be successful in securing new orders; the general stability of the economic, political and regulatory environments within the countries where the Company conducts operations; that the Company will be able to enter into enforceable supply agreements for dissolving pulp on favourable terms and diversify its customer base; the ability of the Company to obtain financing (if necessary) on acceptable terms; that interest and foreign exchange rates will not vary materially from current levels; and that our equipment will operate at expected levels.

Persons reading this MD&A are cautioned that statements comprising forward-looking information are only predictions, and that the Company's actual future results or performance are subject to certain risks and uncertainties including, without limitation: those relating to potential disruptions to production and delivery, including as a result of equipment failures, labour issues, the complex integration of processes and equipment and other factors; fluctuations in the market price for products sold; trade restrictions or import duties imposed by foreign governments; that the Company's continuing efforts to reverse the final dissolving pulp dumping duty will be unsuccessful; labour relations; failure to meet regulatory requirements; changes in the market; potential downturns in economic conditions; fluctuations in the price and supply of required materials; foreign exchange fluctuations; availability of financing (as necessary); dependence on major customers; and other risk factors detailed in our Annual Information Form dated March 31, 2014 available on SEDAR at www.sedar.com and other filings with the Canadian securities regulatory authorities. These risks, as well as others, could cause actual results and events to vary significantly. The Company does not undertake any obligation to update any forward-looking information, except as required by applicable securities law.

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

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

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

Description of Business

The Company was incorporated on May 30, 2006 under the laws of the Province of British Columbia. During the three and six months ended June 30, 2014, the Company operated internationally in two distinct business segments: the Dissolving Pulp Segment, and the Security Paper Products Segment. The Company previously operated its specialty papers business through the Dresden mill located in Germany, where it was a leading international producer of specialty non-woven wallpaper base products. On April 30, 2013, the Company completed the sale of the Dresden mill and no longer operates in the specialty papers industry. Accordingly, references in this MD&A to "discontinued operations" refer to the Specialty Papers Segment.

The Company operates its dissolving pulp business through the Fortress Specialty Cellulose ("FSC") mill located in Thurso, Québec, Canada. The mill expanded into the renewable energy generation sector in October 2013 with the completion of the cogeneration facility. The Company operates its security paper products business through the Landqart mill located in Switzerland, where it produces banknote, passport, visa and other brand protection and security papers, and at its high security production and research facility located in Canada, where it manufactures optically variable thin film material. The segmentation of the Company's manufacturing operations is based on a number of factors, including production, production processes, and economic characteristics.

Overall Performance

EBITDA loss of the Company was $6.0 million for the three months ended June 30, 2014. The Dissolving Pulp Segment generated EBITDA loss of $4.2 million and the Security Paper Products Segment generated EBITDA loss of $0.4 million. Corporate costs contributed $1.4 million to EBITDA loss. For the three months ended March 31, 2014, EBITDA loss was $13.6 million and for the three months ended June 30, 2013, EBITDA loss from continuing operations was $8.4 million.

The Company is encouraged by the FSC mill results in the quarter ended June 30, 2014. Although the dissolving pulp market conditions continue to be challenging, production efficiencies and cash costs have improved during the quarter and relative to comparative periods. The Dissolving Pulp Segment continues to be affected by poor market conditions and the anti-dumping duty imposed by China's Ministry of Commerce ("MOFCOM") in April 2014.

The FSC mill produced 31,039 air dried metric tonnes ("ADMT") of dissolving pulp and 13,693 ADMT of NBHK pulp during the second quarter of 2014. The Company sold 27,723 ADMT of dissolving pulp and 15,620 ADMT of NBHK pulp in the second quarter of 2014.

The Landqart mill continues to implement new initiatives to improve efficiencies and profitability. EBITDA for the Security Paper Products Segment for the quarter ended June 30, 2014 was $3.6 million lower when compared to the first quarter of 2014, and $0.9 million lower compared to the second quarter of 2013. A large production run was shipped in early July and therefore not included in second quarter results. Less than favourable conditions, including the strength of the Swiss franc against the Euro and strong competition for orders putting pressure on pricing, continue to adversely impact the results of the Security Paper Products Segment. The Landqart mill achieved 1,921 tonnes of security paper sales in the second quarter of 2014, compared to 2,583 tonnes of security paper sales in the first quarter of 2014.

Management's Outlook

Dissolving Pulp Segment

The FSC mill dissolving pulp production volumes and production costs continue to improve, a reflection of management's recent initiatives to reduce cash costs and increase production efficiencies. Despite these improvements, results at the FSC mill continue to be impacted by the MOFCOM decision and the current dissolving pulp market.

MOFCOM announced its decision on the final anti-dumping duty for Canadian, American and Brazilian companies on April 4, 2014. The final duty applicable to dissolving pulp produced at the FSC mill is at 13%. With the final duty and its specifications now established, the Company has made improvements in re-establishing a more normalized sales cycle with new and existing customers and remains focused on continued progress to reduce costs and finished goods inventory levels at the mill. The Company is in the process of enhancing its sales and distribution network to increase customer diversification within and outside of China. In addition, management continues to investigate customer mix, and product and geographical diversification of its sales. See "*Significant Developments – China Anti-Dumping Investigation*".

The dissolving pulp market has been weakening since the beginning of 2014, reaching its lowest price in eighteen months of US$840/ADMT (as reported by China Chemical Fibers and Textiles Consultancy Group) during the second quarter of 2014, due to a low pricing environment for viscose staple fibre ("VSF") caused by recent overcapacity. Management believes that, going forward, dissolving pulp markets may be impacted by the following, among other factors:

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

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

- Certain VSF producers are taking action, including taking downtime at their production facilities, which may reduce supply and improve VSF pricing.

Management continues to believe that low dissolving pulp prices are not sustainable in the medium to long term and market dynamics will pressure high cost dissolving pulp mills to change products or shut down. Despite current overcapacity, demand for VSF is expected to continue to grow, primarily as a result of medium to long term reductions in cotton supply, such that additional viscose capacity coming on-line in China will be fully absorbed, leading to an overall increase in demand for dissolving pulp. Cotton future prices remained under pressure during the quarter with thin trading.

After initiating restart procedures in early March 2014, the FSC mill produced NBHK pulp through late April when production was switched to dissolving pulp for the remainder of the second quarter. Dissolving pulp production has exceeded expectations following the smooth transition from NBHK pulp to dissolving pulp. The combined effect of improved production as a result of the work done during the downtime in the first quarter of 2014, cost reduction initiatives to reduce oil consumption, the recent labour cost reduction plan, and stabilized electricity generation, have resulted in an improved cost structure in the second quarter of 2014.

As management expects the dissolving pulp market to remain depressed in the near term, the focus will remain on ongoing cost reduction initiatives underway to position the mill further down the cost curve. Management will swing production between NBHK pulp and dissolving pulp to capitalize on market opportunities. See "*Significant Developments – Labour Cost Reduction Plan*".

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

The final duty imposed by MOFCOM on dissolving pulp imports from all other unnamed current or future Canadian dissolving pulp producers, which would include the FGC mill upon conversion to a dissolving pulp producer exporting into China, was reduced to 23.7%. Despite the reduction, such duty materially impacts the economic viability of converting the FGC mill to a dissolving pulp mill. For accounting purposes, the net book value of the FGC assets were impaired to nil in the fourth quarter of 2013 as a result of the MOFCOM interim duty and uncertainty relating to its final determination. As a result, all ongoing care and maintenance costs incurred in 2014 are expensed in SG&A. The Company is continuing the process of exploring strategic alternatives for the FGC mill to mitigate the financial risk, including divestitures, joint ventures and partnership opportunities. The Company will be comparing the FGC mill investment opportunity to other strategic options for shareholder value creation. Due to changing economics and market conditions, there is no assurance that definitive investment arrangements will be concluded or that the FGC mill project will proceed to completion as previously planned.

Security Paper Products Segment

The Landqart mill continues to have a strong order book consisting of a mix of new and repeat orders. The outlook for further opportunities is positive despite an ongoing competitive market for banknote tenders. Key performance indicators such as waste rates and operational efficiencies have improved in 2014 relative to the prior year period. Results reflect the foregoing, combined with an improved product mix compared to prior year. The decrease in cotton prices during the quarter, specifically prices for cotton linters and cotton combers, will have a positive effect on raw material input costs for future production. Based on the current order book, it is expected that total 2014 production volumes will be comparable to those in 2013. However, product mix, which also has an impact on the financial results of the segment, will vary.

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

Significant Developments

Deferral on Investissement Quebec ("IQ") Loan

On March 31, 2014, the Company announced that it had been granted a deferral on its upcoming principal payment under its $102.4 million project financing loan with IQ relating to its FSC mill (the "IQ Loan"). The Company received, without penalty, a deferral of approximately $4.3 million in principal repayment which was payable in the second quarter of 2014. The Company also received the deferral of $0.8 million in interest during the second quarter of 2014. The principal and interest payments deferral are in addition to the previously disclosed deferral of approximately $5.3 million in principal and interest payments which were payable during the first quarter of 2014. The Company has also received, without penalty, an additional deferral of approximately $4.9 million in principal and interest payments which were payable in the third quarter of 2014. The purpose of these deferrals is to provide the Company with greater financial flexibility and increased working capital. The arrangement reflects the Company's positive ongoing partnership with IQ during this transitory period in the dissolving pulp industry.

China Anti-Dumping Investigation

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

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

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

As part of its strategy to mitigate the adverse effects of the dissolving pulp duty, during the fourth quarter of 2013, the Company successfully completed testing on the ability to operate the FSC mill as a "swing mill". With minor modifications and no capital expenditure, the FSC mill is capable of swinging production from dissolving pulp to NBHK pulp. As a result of the flexibility from being a "swing mill", the FSC mill will be able to lower its cost structure accordingly when redirecting production from dissolving pulp to NBHK pulp, which, relative to dissolving pulp, is simpler to produce and has a higher yield derived from the same fibre source. The FSC mill is capable of shifting production between different products to maximize margins in response to changing market conditions, and will achieve a capacity increase of approximately 25% when redirecting production from dissolving pulp to NBHK pulp. Such expected advantages are subject to market pricing of NBHK pulp compared to dissolving pulp and whether such pricing is sufficient for sustained operations. The Company anticipates that the adverse impact of the dumping tariff will be limited to the short-term as trade patterns realign to effectively nullify any duty, and expects that global dissolving pulp prices should normalize over the long-term. The redesign of the FSC mill allows the Company to focus production on the most profitable pulp markets in the interim. The Company is also in the process of expanding its dissolving pulp sales network outside of China in order to secure the best pricing for its dissolving pulp and further mitigate the impact of the duty imposed by MOFCOM.

Durasafe®

In May 2014, the Company announced that the Durasafe® banknote paper developed by the Landqart mill has been confirmed as the substrate of the ninth series of the Swiss Franc by the SNB. Durasafe® is the innovative new composite paper-polymer-paper banknote substrate developed by the Landqart mill, in cooperation with the Swiss Federal Institute of Technology (ETH) Zürich.

FSC Power Supply Agreement

In May 2014, the Company announced that the FSC mill was awarded a power supply agreement by Hydro Quebec for an additional 5.2 MW of power (for a total of 24 MW) to be produced at its cogeneration facility. This increase is expected to result in significant incremental revenue, which will translate into an anticipated overall cost savings at the FSC mill of approximately $2.7 million annually with an opportunity for further optimization. Pursuant to the new power supply agreement, the FSC mill is expected to begin delivering the additional power by April 2015, with a provision to start delivering power as early as the fourth quarter of 2014.

Labour Cost Reduction Plan

In June 2014, the Company announced the approval of an employee reduction plan that will result in a reduction of approximately 16% of the salaried staff in the dissolving pulp segment. The reduction included senior management, middle management and clerical staff. The impact in cost savings has been estimated at approximately $2.2 million per annum. The layoffs resulted from a management directive to immediately reduce labour costs as part of a comprehensive cost reduction initiative undertaken in response to the challenging dissolving pulp market.

Selected Quarterly Information

(thousands of dollars, except per share amounts, exchange rates and shares outstanding, unaudited)	Q2 2014	Q1 2014	Q4 2013	Q3 2013
Sales from continuing operations	67,262	53,856	37,183	53,160
Net loss from continuing operations	(20,108)	(23,421)	(54,731)	(13,427)
Net loss [1]	(20,766)	(23,421)	(54,731)	(12,436)
Basic net loss per share from continuing operations	(1.38)	(1.61)	(3.76)	(0.92)
Diluted net loss per share from continuing operations	(1.38)	(1.61)	(3.76)	(0.92)
Basic net loss per share [1]	(1.42)	(1.61)	(3.76)	(0.85)
Diluted net loss per share[1]	(1.42)	(1.61)	(3.76)	(0.85)
Weighted average shares outstanding - Basic (thousands)	14,591	14,586	14,574	14,561
Weighted average shares outstanding - Diluted (thousands)	14,591	14,586	14,574	14,561
Average Swiss/Canadian exchange rate[2]	1.2268	1.2358	1.1626	1.1147
Average Euro/Canadian exchange rate [2]	1.4955	1.5117	1.4291	1.3759
Average US dollar/Canadian exchange rate [2]	1.0905	1.1033	1.0494	1.0386

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

(thousands of dollars, except per share amounts, exchange rates and shares outstanding, unaudited)	Q2 2013	Q1 2013	Q4 2012	Q3 2012
Sales from continuing operations	59,883	57,559	58,747	38,257
Net loss from continuing operations	(20,851)	(18,814)	(9,914)	(24,051)
Net income (loss) [1]	134,125	(12,373)	(4,226)	(19,061)
Basic net loss per share from continuing operations	($1.43)	($1.30)	($0.68)	($1.67)
Diluted net loss per share from continuing operations	($1.43)	($1.30)	($0.68)	($1.67)
Basic net loss per share[1]	$9.23	($0.85)	($0.29)	($1.32)
Diluted net income (loss) per share[1]	$9.23	($0.85)	($0.29)	($1.32)
Weighted average shares outstanding - Basic (thousands)	14,536	14,502	14,492	14,394
Weighted average shares outstanding - Diluted (thousands)	14,536	14,502	14,492	14,394
Average Swiss/Canadian exchange rate[2]	1.0862	1.0837	1.0645	1.0340
Average Euro/Canadian exchange rate [2]	1.3367	1.3312	1.2857	1.2445
Average US dollar/Canadian exchange rate [2]	1.0231	1.0083	0.9913	0.9953

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

Fluctuations in quarterly results reflect significant transactions and developments within the Company. Throughout 2012, production rates improved in the Dissolving Pulp Segment as the ramp-up at the FSC mill continued, albeit at a slower pace than first anticipated and without operating at the intended fully ramped up rate or designed efficiency levels. In the third quarter of 2012, the FSC mill had its annual extended maintenance shutdown, as well as an unplanned outage due to a temporary recovery boiler issue which both contributed to lower shipments and production during the quarter. During the fourth quarter of 2012, the Dissolving Pulp Segment saw stable production with the highest volumes of dissolving pulp produced during any quarter up to that date. As such, sales were higher, but continued deterioration in dissolving pulp prices impacted earnings, which overshadowed improved production. The first quarter of 2013 was characterized by production challenges and the lowest realized dissolving pulp prices experienced to date at that time, which contributed to disappointing results from the Dissolving Pulp Segment. Operating results improved in the second quarter of 2013 compared to the prior quarter after the planned ten day maintenance shut-down. Net loss from continuing operations was negatively impacted by a large deferred income tax expense that was accounted for in the second quarter. The third quarter of 2013 was characterized by continued depressed dissolving pulp prices, trial runs of NBHK pulp, and higher inventory levels. Dissolving pulp sales activity was suspended entirely in the fourth quarter of 2013 as a result of the challenges caused by the announcement of the MOFCOM interim duty. As a consequence of the duty, the FGC mill assets were impaired by $32.9 million in addition to a $3.7 million inventory write-down at the FSC mill. The FSC mill produced NBHK pulp for approximately one month in the fourth quarter and initiated market downtime mid-December for approximately ten weeks. The first quarter of 2014 was impacted by the market downtime and a difficult March ramp-up. The FSC mill produced NBHK through to late April when production was switched to dissolving pulp and continued through the end of the second quarter of 2014. The second quarter of 2014 saw production and costing improvements as a result of management initiatives to increase production efficiencies. Results continue to be impacted by poor market conditions and the final MOFCOM determination.

Product mix, high raw material costs, pricing pressure, a strong Swiss currency, and less than optimal production efficiency at the Landqart mill contributed to a disappointing and difficult 2012 year for the Security Paper Products Segment, which materially impacted the Company’s quarterly results throughout the year. Net income for the second quarter of 2012 was significantly impacted by the sale of the hydropower assets and associated real estate at the Landqart mill to a Swiss utility company for proceeds of CHF 18 million. An increase in volume sold during 2013 contributed to improving metrics, higher sales and better results for the Security Paper Products Segment. The first quarter of 2013 was impacted by a realized gain of $1.9 million on the sale of non-core assets and included in the fourth quarter of 2013 was a $1.3 million legal provision. The first six months of 2014 continued with strong volumes and a slightly favourable product mix resulting in improved results.

Second Quarter 2014 Earnings Review

Three Months Ended June 30

Overview

EBITDA loss of the Company was $6.0 million for the three months ended June 30, 2014. The Dissolving Pulp Segment generated EBITDA loss of $4.2 million and the Security Paper Products Segment generated EBITDA loss of $0.4 million. Corporate costs contributed $1.4 million to EBITDA loss. For the three months ended March 31, 2014, EBITDA loss was $13.6 million and for the three months ended June 30, 2013, EBITDA loss from continuing operations was $8.4 million.

Fortress reported an adjusted net loss from continuing operations of $18.4 million, or diluted adjusted net loss per share from continuing operations of $1.26 for the second quarter of 2014 on sales of $67.3 million. In the first quarter of 2014, the Company reported an adjusted net loss from continuing operations of $25.9 million or diluted adjusted net loss per share from continuing operations of $1.77 on sales of $53.9 million, and for the second quarter of 2013, an adjusted net loss from continuing operations of $20.6 million or diluted adjusted net loss per share from continuing operations of $1.42 on sales of $59.9 million.

Fortress reported net loss from continuing operations of $20.1 million, or diluted net loss per share from continuing operations of $1.38 for the second quarter of 2014. In the first quarter of 2014, the Company reported net loss from continuing operations of $23.4 million or diluted net loss per share from continuing operations of $1.61, and for the second quarter of 2013, net loss from continuing operations of $20.9 million or diluted net loss per share from continuing operations of $1.43.

Manufacturing, product, freight and other distribution costs from continuing operations were $61.6 million for the three months ended June 30, 2014, compared to $54.9 million for the three months ended March 31, 2014. In the second quarter of 2013, manufacturing, product, freight and other distribution costs from continuing operations were $58.3 million.

Selling, general and administrative ("SG&A") expenses were $11.6 million for the second quarter of 2014, compared to $12.6 million for the first quarter of 2014. The prior year comparative period SG&A from continuing operations was $9.9 million. SG&A was higher in the first quarter of 2014 primarily as a result of a non-reoccurring increase in logistic fees for finished goods held offsite pending completion of sales of pulp into China. SG&A was higher in the second quarter of 2014 than the second quarter of 2013, primarily as a result of the translation of our Security Products Segment for reporting purposes reflecting the effect of the strengthening of the Swiss Franc compared to the Canadian dollar as well as ongoing care and maintenance costs at our FGC mill which was previously capitalized to property, plant and equipment.

Stock-based compensation expense was $(0.4) million during the second quarter of 2014, compared to $0.2 million in the first quarter of 2014. The prior year comparative period stock-based compensation expense was $0.7 million. Stock based compensation expense in the three months ended June 30, 2014 was impacted by a reversal of stock based compensation relating to a change in estimate for certain financial performance based compensation awards.

Selected Financial Information and Statistics

(thousands of dollars, except shipments, unaudited)	**Q2 2014**	**Q1 2014**	**Q2 2013**
Sales from continuing operations	67,262	53,856	59,883
EBITDA from continuing operations[1]	(5,994)	(13,626)	(8,356)
EBITDA[2] [3]	(5,994)	(13,626)	(4,934)
Net loss from continuing operations	(20,108)	(23,421)	(20,851)
Net loss [3]	(20,766)	(23,421)	134,125
Adjusted net loss from continuing operations [4]	(18,438)	(25,858)	(20,632)
Paper shipments (tonnes) [5]	1,921	2,583	1,953
Pulp shipments (ADMT)	43,343	20,259	38,006

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

Net Loss to Adjusted Net Loss Reconciliation for Continuing Operations:

(thousands of dollars, except per share amounts, unaudited)	**Q2 2014**	**Q1 2014**	**Q2 2013**
Net loss from continuing operations	(20,108)	(23,421)	(20,851)
Foreign exchange loss (gain)	1,670	(1,562)	(534)
(Gain) loss on sale of property, plant and equipment	-	(875)	753
Adjusted net loss	(18,438)	(25,858)	(20,632)
Basic and diluted net loss per share	(1.38)	(1.61)	(1.43)
Adjusted net loss per share, basic and diluted	(1.26)	(1.77)	(1.42)

Net Loss to EBITDA Reconciliation for Continuing Operations:

(thousands of dollars, unaudited)	Q2 2014	Q1 2014	Q2 2013
Net loss	(20,108)	(23,421)	(20,851)
Income tax (recovery) expense	(32)	(14)	3,392
Foreign exchange loss (gain)	1,670	(1,562)	(534)
Net finance expense	5,623	5,683	3,944
Amortization	7,219	6,325	4,281
(Gain) loss on sale of property, plant and equipment	-	(875)	753
Stock based compensation	(366)	238	659
EBITDA	(5,994)	(13,626)	(8,356)

Net Loss to EBITDA Reconciliation Including Discontinued Operations:

(thousands of dollars, unaudited)	Q2 2014	Q1 2014	Q2 2013
Net loss	(20,766)	(23,421)	134,125
Income tax (recovery) expense	(32)	(14)	3,951
Foreign exchange loss (gain)	1,670	(1,562)	(534)
Net finance expense	5,623	5,683	5,105
Amortization	7,219	6,325	4,281
Loss (gain) on disposal of business	658	-	(153,274)
(Gain) loss on sale of property, plant and equipment	-	(875)	753
Stock based compensation	(366)	238	659
EBITDA	(5,994)	(13,626)	(4,934)

Operating Results by Business Segment

Dissolving Pulp Segment

(thousands of dollars, except for shipments, unaudited)	Q2 2014	Q1 2014	Q2 2013
Sales	38,416	15,282	29,343
Operating loss	(9,170)	(19,360)	(8,828)
Amortization	4,961	4,104	2,349
EBITDA	(4,209)	(15,256)	(6,479)
NBHK Pulp Shipments (ADMT)	15,620	11,410	-
Dissolving Pulp Shipments (ADMT)	27,723	8,849	38,006

In October 2013, the FSC mill successfully completed the mandatory testing for its cogeneration facility and began delivering power to Hydro Québec at the contracted commercial rate. The cogeneration facility generated $3.9 million in sales revenue from the generation of power during the quarter ended June 30, 2014. Revenues from the generation of power at the cogeneration facility during the quarter ended March 31, 2014 were negatively impacted by the planned ten week market downtime resulting in $0.1 million in sales revenue.

As at June 30, 2014, the FSC mill held finished goods inventory consisting of 22,032 ADMT of dissolving pulp and 9,312 ADMT of NBHK pulp. At March 31, 2014, the mill held finished goods inventory consisting of 18,716 ADMT of dissolving pulp and 11,240 ADMT of NBHK pulp. The mill did not hold material amounts of dissolving pulp at the end of the prior year comparative period. Inventory levels were high in the fourth quarter of 2013 and subsequently through to the end of the second quarter of 2014 as a result of sales and shipments during these periods being significantly lower, compared to the prior year comparative periods, a direct effect of the MOFCOM duty and consequent uncertainty created in the marketplace.

The FSC mill produced NBHK at the beginning of the second quarter of 2014 and switched to dissolving pulp production in late April. After a challenging ramp-up in the first quarter of 2014 following market downtime, the FSC mill achieved much improved production volumes and production costs since the previous quarter.

Security Paper Products Segment

(thousands of dollars, except for shipments, unaudited)	Q2 2014	Q1 2014	Q2 2013
Sales	28,846	38,574	30,540
Operating (loss) income	(2,666)	993	(1,392)
Amortization	2,258	2,221	1,932
EBITDA	(408)	3,214	540
Shipments (tonnes)	1,921	2,583	1,953

Operating loss at the Landqart mill for the second quarter of 2014 was $2.7 million compared to operating income in the first quarter of 2014 of $1.0 million. The operating loss in the current quarter reflects product mix as well as timing of deliveries, as evidenced by lower tonnage shipped in the current quarter.

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

Fortress Optical Features Ltd. ("Fortress Optical") generated sales of $1.0 million in the second quarter of 2014 compared to $0.4 million in the first quarter of 2014. In the second quarter of 2013, $0.8 million of sales revenue was generated. Fortress Optical began operations in 2011. Fortress Optical produces security material for security threads used in banknotes at the Fortress Optical Facility.

Six Months Ended June 30

Selected Financial Information and Statistics for the Six Months Ended:

(thousands of dollars, except for shipments, unaudited)	June 30, 2014	June 30, 2013
Sales from continuing operations	121,118	117,442
EBITDA from continuing operations[1]	(19,620)	(21,518)
EBITDA[2] [3]	(19,620)	(7,561)
Net loss from continuing operations	(43,529)	(39,665)
Net loss [3]	(44,187)	121,752
Adjusted net loss from continuing operations [4]	(44,296)	(41,250)
Paper shipments (tonnes) [5]	4,504	4,132
Pulp shipments (ADMT)	63,602	77,272

(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)	June 30, 2014	June 30, 2013
Net loss from continuing operations	(43,529)	(39,665)
Foreign exchange loss (gain)	108	(478)
Gain on sale of property, plant and equipment	(875)	(1,107)
Adjusted net loss from continuing operation	(44,296)	(41,250)
Basic and diluted net (loss) per share	(2.98)	(2.73)
Adjusted net loss per share, basic and diluted	(3.04)	(2.84)

Net Loss to EBITDA Reconciliation for Continuing Operations:
(thousands of dollars, unaudited)

	June 30, 2014	June 30, 2013
Net loss from continuing operations	(43,529)	(39,665)
Income tax	(46)	1,577
Foreign exchange (gain) loss	108	(478)
Net finance expense	11,306	7,953
Amortization	13,544	8,615
Gain (loss) on sale of property, plant and equipment	(875)	(1,107)
Stock based compensation	(128)	1,587
EBITDA	(19,620)	(21,518)

Net (Loss) Income to EBITDA Reconciliation Including Discontinued Operations:
(thousands of dollars, unaudited)

	June 30, 2014	June 30, 2013
Net (loss) income	(44,187)	121,752
Income tax	(46)	5,095
Foreign exchange loss (gain)	108	(453)
Net finance expense	11,306	9,479
Amortization	13,544	9,360
Gain on disposal of business	658	(153,274)
(Gain) loss on sale of property, plant and equipment	(875)	(1,107)
Stock based compensation	(128)	1,587
EBITDA	(19,620)	(7,561)

Overview

EBITDA loss for the Company from continuing operations was $19.6 million for the six months ended June 30, 2014 on sales of $121.1 million compared to $21.5 million in the six months ended June 30, 2013 on sales of $117.4 million. The poor results in 2014 reflect the ten week market downtime at the FSC mill announced in mid-December 2013, and unusually cold temperatures at the mill site which increased heating costs both during the mill's downtime and the subsequent start-up period. These results were slightly offset by better performance at the security paper segment and fewer costs incurred at corporate level compared to 2013.

The Security Paper Products Segment generated EBITDA of $2.8 million in the six months ended June 30, 2014 compared to EBITDA loss of $1.6 million in the prior year comparative. The Dissolving Pulp Segment generated an EBITDA loss of approximately $19.5 million in the first six months of 2014 compared to $15.2 million EBITDA loss in the prior year comparative period. Corporate costs contributed EBITDA loss of $2.9 million and $4.8 million in the six months ended June 30, 2014 and 2013, respectively.

Adjusted net loss from continuing operations for the six month period ended June 30, 2014 was $44.3 million or $3.04 per share basic. Adjusted net loss from continuing operations for the prior comparative period was $41.3 million or $2.84 per share basic.

Manufacturing, product, freight and other distributions costs equaled $116.5 million for the six months ended June 30, 2014 compared to $119.2 million in the six months ended June 30, 2013. The lower cost in 2014 reflects increased tonnage sold at the security paper division that was produced at a lower cost. The cost savings in the security division is a result of the ongoing initiatives to optimize production.

SG&A expenses were $24.2 million for the six months ended June 30, 2014 compared to $19.7 million in the prior year comparative figure. The increase in the current year SG&A is in part due to additional logistic costs incurred resulting from the MOFCOM investigation and determination. For accounting purposes, the net book value of the FGC assets were impaired to $nil in the fourth quarter of 2013 as a result of the MOFCOM interim duty and its uncertainty relating to its final determination. As a result, all ongoing care and maintenance costs incurred in 2014 are expensed in SG&A. Also, during the six months ended June 30, 2014, the cogeneration facility was operational and incurred additional costs reflecting higher insurance, professional fees and property taxes relating to the facility.

Stock based compensation was $(0.1) million for the six months ended June 30, 2014 compared to $1.6 million in the previous comparative period. Stock based compensation expense for the six months ended June 30, 2014 was impacted by a reversal of stock based compensation relating to a change in estimate for certain financial performance based compensation awards.

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

Operating Results by Business Segment

Dissolving Pulp Segment

	Six Months Ended	
(thousands of dollars, except for shipments, unaudited)	June 30, 2014	June 30, 2013
Sales	53,698	58,229
Operating loss	(28,530)	(19,854)
Amortization	9,065	4,698
EBITDA	(19,465)	(15,156)
NBHK Pulp Shipments (ADMT)	27,030	-
Dissolving Pulp Shipments (ADMT)	36,572	77,272

Results for the first six months of 2014 at the FSC mill were impacted by a slow and challenging ramp up after the planned ten week shut, the impact of the final anti-dumping duty determination and related charges. Compounding the impact on results were the lowest realized sales prices to date due to weakening market prices of dissolving pulp.

Results for the first six months of 2013 at the FSC mill were impacted by production challenges related to the digester and evaporator and a planned ten day maintenance shut-down.

Security Paper Products Segment

(thousands of dollars, except for shipments, unaudited)	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Sales	67,420	59,213
Operating loss	(1,673)	(5,514)
Amortization	4,479	3,917
EBITDA	2,806	(1,597)
Shipments (tonnes)	4,504	4,132

The six month period ended June 30, 2014 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.

Selected Cash Flow Items

	Q2 2014	Q1 2014	Six Months Ended June 30, 2014	Q2 2013	Six Months Ended June 30, 2013
Cash provided by (used by) operating activities					
Cash used by before working capital changes	(5,593)	(13,604)	(19,197)	(4,907)	(10,519)
Non-cash working capital change	12,375	(1,954)	10,421	7,076	8,704
	6,782	(15,558)	(8,776)	2,169	(1,815)
Cash used by financing activities	(5,225)	(33)	(5,258)	(73,051)	(57,868)
Cash (used) generated by investing activities					
Additions to property, plant and equipment	(3,200)	(2,123)	(5,323)	(24,688)	(42,415)
Other	1,331	(2,128)	(797)	199,068	203,501
	(1,869)	(4,251)	(6,120)	174,380	161,086
Change in cash position	(312)	(19,842)	(20,154)	103,498	101,403
Foreign exchange (loss) gain on cash and cash equivalents	(1,072)	1,051	(21)	2,981	3,263
Cash and cash equivalents, beginning of year	43,097	61,888	61,888	29,678	31,491
Cash and cash equivalents, end of period	41,713	43,097	41,713	136,157	136,157

Operating Activities

Fortress operates in a cyclical industry and its operating cash flows vary accordingly. Fortress' principal operating cash expenditures are for labour and raw materials. Operating activities used cash of $8.8 million and $1.8 million in the six months ended June 30, 2014 and 2013, respectively. Working capital is subject to cyclical operating needs, the timing of collection of receivables and the payment of payables and expenses. The movement in working capital in the second quarter of 2014 was impacted by a decrease in other accounts receivable, inventories levels and increased accounts payable.

Financing Activities

During the first six months of 2014, financing activities used cash of $5.3 million. The Company deferred $10.4 million in planned principal and interest payments on the IQ Loan that were payable during this period. Deferred amounts are amortized and repayable in equal quarterly instalments during the remaining term of the IQ Loan maturing June 30, 2020.

During the first six months of 2013, financing activities used cash of $57.9 million. During the period, Dresden entered into two credit facilities in the aggregate amount of €15 million with Commerzbank AG. The new facilities were comprised of a €5 million tranche and a €10 million tranche which were repaid, together with all other outstanding Dresden indebtedness, as a condition of and concurrently with the closing of the sale of the Dresden mill. A penalty of $1.2 million was paid in connection with the early repayment of all the Dresden indebtedness.

Investing Activities

Investing activities in the first six months of 2014 used cash of $6.1 million. Investment activities relating to the purchase of equipment and other capital expenditures at the mills was $5.3 million. $1.7 million of restricted cash was added during the first quarter of 2014. Restricted cash relates to cash security provided primarily for banknote contracts in the Security Paper Products Segment.

Investing activities in the first six months of 2013 provided cash of $161.1 million. The sale of Dresden resulted in cash proceeds of $212.2 million which were offset by $42.4 million in additions to property, plant and equipment primarily at the FSC mill and $11.8 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 $3.8 million.

Liquidity and Capital Resources

As at June 30, 2014, the Company had a cash and cash equivalents balance of $41.7 million. The Company anticipates that approximately $15.5 million in project capital expenditures will be required through to the end of 2015 in order to achieve production efficiency targets and health, safety and environmental objectives.

Although there can be no assurances, Fortress believes that current cash, cash generated from operations, cashflow derived from sale of built-up inventory to normalized levels and the sale of non-core assets, should be sufficient to meet its debt service, capital expenditure and short term working capital requirements. Fortress has also entered, in the normal course, into pulp distribution arrangements for inventory management, logistics, and ancillary services relating to pulp being distributed by the FSC mill, which the company expects will also improve financial flexibility in response to market fluctuations. Fortress' future operating performance and its ability to finance capital expenditures, service its debt and pay other indebtedness will be subject to future economic conditions, the potential renegotiation of existing indebtedness, the financial success of Fortress' business, the successful ability to swing production between dissolving pulp and NBHK pulp at the FSC mill to maximize margins in response to changing market conditions, combined with the cost benefits expected to be derived from the now operational cogeneration facility and other cost savings initiatives, and other factors, some of which are not within Fortress' control, including but not limited to changes in market prices for its products, raw materials costs, foreign currency exchange rates and the MOFCOM duty. No assurances are given as to the likelihood that the outcome of any such factors will be successful or will operate to positively impact the Company's business, operations and/or financial results.

In addition, Fortress may in the normal course of business advance the amount of duties owing on the importation of dissolving pulp into China. Fortress may determine, in its sole discretion, that market or financial conditions may warrant that it seek additional sources of capital on terms satisfactory to Fortress, including, but not limited to additional debt or equity financing, in order to fund capital expenditures, provide additional working capital, enhance liquidity or for other general corporate purposes.

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

Principal repayments of debt outstanding as at June 30, 2014 are required as follows:

	($ 000's)
2014	5,489
2015	19,888
2016	60,675
2017	45,701
2018	18,940
Thereafter	97,640
	248,333

Under existing credit facilities, the Company has deferred $10.4 million in planned principal and interest payments on the IQ Loan which was payable in the first six months of 2014, without penalty. The Company has also received, without penalty, an additional deferral of approximately $4.9 million in principal and interest payments which were payable in the third quarter of 2014. The Company also received non-refundable grants from IQ in the aggregate amount of approximately $0.2 million in the first six months of 2014 and expects to receive a further $1.0 million in respect of the same period to cover certain costs and expenses relating to the care and maintenance of the FGC mill. The Company received approximately $0.6 million in 2013 for costs incurred from July 2013 to and including November 2013. IQ agreed to provide such grants through to the end of September 2014.

Commitments

As at June 30, 2014, the Company had aggregate indebtedness of $232.1 million and net working capital of $87.9 million.

As at June 30, 2014 the Company has:

- committed to purchase $3.8 million in property, plant, and equipment;
- performance bonds in the amount of €11.3 million; and
- committed to purchase steam from a supplier up to the end of 2015 for CHF0.9 million per year.

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

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

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

(thousands of dollars, unaudited)	June 30, 2014 $	December 31, 2013 $
Cash and cash equivalents	41,713	61,888
Less total debt	232,128	228,130
Net debt	(190,415)	(166,242)
Shareholders' equity	258,987	302,278

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

The Company ensures it remains in compliance with all of its existing debt covenants in order to facilitate future access to capital. Management reviews past results and forecasts to monitor their compliance. The Company was in compliance with all externally imposed capital requirements for the period ended June 30, 2014.

Outstanding Shares

The number of common shares outstanding at June 30, 2014 and the date of this report was 14,615,202 and 14,631,871. The number of options outstanding at June 30, 2014 and the date of this report was 590,725. At June 30, 2014 and the date of this report there were 247,020 restricted share units outstanding. At June 30, 2014 and the date of this report there were 185,111 and 181,489 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 into employment agreements. Further information is contained in our management information circulars in respect of our annual general meetings of shareholders, which are filed on SEDAR at www.sedar.com.

Contingencies

Provisions for liabilities relating to legal actions and claims require judgments using management's best estimates regarding projected outcomes and the range of loss, based on such factors as historical experiences and recommendations of legal counsel. Actual results may vary from estimates and the differences are recorded when known.

Critical Accounting Estimates

For a review of significant management judgments affecting financial results and critical accounting estimates, see the Management's Discussion and Analysis for the year ended December 31, 2013, available on SEDAR.

New Accounting Pronouncements

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

Risks and Uncertainties

A comprehensive discussion of risk factors is included in the Company's Annual Information Form dated March 31, 2014, available on SEDAR at www.sedar.com. Those as well as risks detailed in the Management's Discussion and Analysis for the year ended December 31, 2013, also available on SEDAR, may impact the business of the Company.

Disclosure Controls and Internal Controls over Financial Reporting

During the quarter ended June 30, 2014, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Canadian dollars, amounts in thousands, unaudited)

	Note	June 30, 2014 $	December 31, 2013 $
ASSETS			
Current			
Cash and cash equivalents		41,713	61,888
Restricted cash		16,665	14,934
Trade accounts receivable		22,358	12,446
Other accounts receivable		8,267	8,751
Inventories		60,080	62,390
Prepaid expenses	6	7,199	8,486
		156,282	168,895
Property, plant and equipment		404,909	412,949
Total assets		561,191	581,844
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities		53,474	34,044
Current portion of long-term debt	6	14,865	14,572
		68,339	48,616
Long-term debt	6	217,263	213,558
Deferred income taxes		4,666	4,734
Provisions and other long-term liabilities		6,653	7,921
Employee future benefits		5,283	4,737
Total liabilities		302,204	279,566
Shareholders' equity			
Share capital	7	180,696	180,040
Contributed surplus		25,166	25,950
Retained earnings		31,089	75,368
Accumulated other comprehensive income		22,036	20,920
Total shareholders' equity		258,987	302,278
Total liabilities and shareholders' equity		561,191	581,844

(See accompanying notes)

Approved by the Board of Directors:

"Chadwick Wasilenkoff" — Director

"Anil Wirasekara" — Director

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Canadian dollars, amounts in thousands, unaudited)

	Note	Three Months Ended June 30, 2014 $	Three Months Ended June 30, 2013 $	Six Months Ended June 30, 2014 $	Six Months Ended June 30, 2013 $
Sales		67,262	59,883	121,118	117,442
Costs and expenses					
Manufacturing and product costs		(56,784)	(57,545)	(109,116)	(117,818)
Freight and other distribution costs		(4,852)	(766)	(7,373)	(1,418)
Amortization		(7,219)	(4,281)	(13,544)	(8,615)
Selling, general and administration		(11,620)	(9,928)	(24,249)	(19,725)
Stock-based compensation		366	(659)	128	(1,586)
Operating loss		(12,847)	(13,296)	(33,036)	(31,720)
Other income (expense)					
Finance expense		(5,779)	(4,004)	(11,532)	(8,037)
Finance income		156	60	226	84
(Loss) gain on sale of property, plant and equipment	5	–	(753)	875	1,107
Foreign exchange (loss) gain		(1,670)	534	(108)	478
Net (loss) from continuing operations before income taxes		(20,140)	(17,459)	(43,575)	(38,088)
Income tax recovery (expense)		32	(3,392)	46	(1,577)
Net (loss) income from continuing operations		(20,108)	(20,851)	(43,529)	(39,665)
Net (loss) income from discontinued operations	4	(658)	154,976	(658)	161,417
Net (loss) income		(20,766)	134,125	(44,187)	121,752
Loss and diluted loss per share from continuing operations		(1.38)	(1.43)	(2.98)	(2.73)
(Loss) earnings per share and diluted (loss) earnings per share		(1.42)	9.23	(3.03)	8.39
Weighted average number of shares outstanding Basic and diluted		14,590,571	14,536,451	14,588,345	14,519,283

(See accompanying notes)

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

(Canadian dollars, amounts in thousands, unaudited)

	Three Months Ended June 30, 2014 $	Three Months Ended June 30, 2013 $	Six Months Ended June 30, 2014 $	Six Months Ended June 30, 2013 $
Net (loss) income	(20,766)	134,125	(44,187)	121,752
Other comprehensive (loss) income				
Items that may be reclassified subsequently to net income				
Exchange differences on translation of foreign operations	(4,097)	8,860	1,116	7,979
Items that will not be reclassified to net (loss) income				
Actuarial (loss) gain recognized on employee future benefits (net of taxes of $160, ($324) and $18, ($580))	(795)	1,619	(92)	2,901
Total other comprehensive (loss) income	(4,892)	10,479	1,024	10,880
Total comprehensive (loss) income	(25,658)	144,604	(43,163)	132,632

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Canadian dollars, amounts in thousands, unaudited)

	Note	Six Months Ended June 30, 2014 $	Six Months Ended June 30, 2013 $
Share capital	7		
Balance at beginning of period		180,040	178,052
Restricted share units vested		656	635
Deferred share units vested		–	369
Balance at end of period		180,696	179,056
Contributed surplus			
Balance at beginning of period		25,950	26,078
Stock-based compensation		(128)	1,586
Early vesting of restricted share units on sale of business		–	221
Restricted share units vested		(656)	(635)
Deferred share units vested		–	(369)
Balance at end of period		25,166	26,881
Retained earnings			
Balance at beginning of period		75,368	23,387
Net (loss) income		(44,187)	121,752
Defined benefit plan actuarial gain, net of tax		(92)	2,901
Balance at end of period		31,089	148,040
Accumulated other comprehensive income			
Balance at beginning of period		20,920	2,152
Cumulative translation adjustment on foreign operations		1,116	7,979
Balance at end of period		22,036	10,131
Total equity		258,987	364,108

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Canadian dollars, amounts in thousands, unaudited)

	Note	Six Months Ended June 30, 2014 $	Six Months Ended June 30, 2013 $
Cash flows from (used by) operating activities			
Net (loss) income for the period		(44,187)	121,752
Adjustments:			
Loss (gain) on disposal of business	4	658	(153,274)
Gain on sale of property, plant and equipment	5	(875)	(1,107)
Amortization		13,544	9,361
Income tax (recovery) expense		(46)	5,139
Income taxes paid		–	(2,720)
Foreign exchange loss (gain)		305	(674)
Finance expense		11,532	9,418
Stock-based compensation		(128)	1,586
		(19,197)	(10,519)
Change in non-cash working capital items			
Accounts receivable		(9,607)	6,170
Inventories		2,602	9,086
Prepaid expenses		(741)	(815)
Accounts payable and accrued liabilities and other		18,167	(5,737)
		(8,776)	(1,815)
Cash flows from (used by) financing activities			
Repayment of long-term debt		(129)	(51,052)
Proceeds from long-term debt		–	19,860
Repurchase of factored accounts receivable		–	(18,006)
Long-term debt prepayment penalty		–	(1,166)
Payment of long-term debt interest		(5,129)	(7,504)
		(5,258)	(57,868)
Cash flows from (used by) investing activities			
Additions to property, plant and equipment		(5,323)	(42,415)
Proceeds from sale of business	4	–	212,240
Adjustments and costs associated with sale of business		–	(771)
Proceeds from sale of property, plant and equipment	5	875	3,802
Restricted cash		(1,672)	(11,770)
		(6,120)	161,086
(Decrease) increase in cash position		(20,154)	101,403
Foreign exchange gain on cash and cash equivalents		(21)	3,263
Cash and cash equivalents, beginning of year		61,888	31,491
Cash and cash equivalents, end of period		41,713	136,157

(See accompanying notes)

1. NATURE OF OPERATIONS

Fortress Paper Ltd. (the "Company" or "Fortress") was incorporated on May 30, 2006 under the laws of the Province of British Columbia. The address of the Company's registered office is 157 Chadwick Court – 2nd floor, North Vancouver, British Columbia, Canada V7M 3K2. Fortress operates internationally in two distinct business segments: dissolving pulp and security paper products. The Company operates its dissolving pulp business at the Fortress Specialty Cellulose mill located in Canada. As of September of 2013, the Fortress Specialty Cellulose mill also operates in the renewable energy sector with the completion of a cogeneration facility. The Company is also evaluating expanding its dissolving pulp capacity by converting the Fortress Global Cellulose mill located at Lebel-sur-Quévillon, Québec into a dissolving pulp mill and re-starting the cogeneration facility. Up to April 30, 2013, the Company operated its specialty papers business at the Dresden mill located in Germany, where it was a producer of specialty non-woven wallpaper base products. The Company operates its security paper products business at the Landqart mill located in Switzerland, where it produces banknote, passport, visa and other brand protection and security papers, and at its Fortress Optical Facility located in Canada, where it manufactures optically variable thin film material.

2. BASIS OF PRESENTATION

These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB"). The Board of Directors approved these statements on August 5, 2014.

These unaudited interim financial statements do not include all of the disclosures required by IFRS for annual financial statements and, accordingly, should be read in conjunction with the consolidated financial statements and notes as at and for the year ended December 31, 2013 (available on SEDAR at www.sedar.com). These unaudited interim financial statements follow the same accounting policies and methods of their application as December 31, 2013 consolidated financial statements, with the exception of the changes in Note 3 below. For significant estimates and judgments refer to the consolidated financial statements and notes as at and for the year ended December 31, 2013.

3. NEW ACCOUNTING PRONOUNCEMENTS

Changes in accounting policies

IFRIC 21 – Levies

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

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

4. DISPOSAL OF BUSINESS

On April 30, 2013, the Company sold all of the shares of its wholly owned subsidiary, Dresden Papier GmbH (the "Dresden mill"), which represented the entire specialty papers segment of the Company, for an aggregate purchase price of EUR 160,000 subject to working capital and other adjustments. The transaction excluded cash and long-term debt associated with the Dresden mill. Prior to the sale, the long term debt associated with Dresden was repaid by the Company and the factored accounts receivable of the Dresden mill were repurchased. An early prepayment penalty of $1,166 was recorded on the retirement of the Dresden mill long term debt. Based on the book values of the net assets disposed of, the related sales proceeds, and the effect of foreign exchange, the gain on disposal of Dresden mill is $154,265, as summarized below. During the three months ended June 30, 2014, the Company recorded an additional $658 against the gain on disposal relating to taxes owed on the sale. 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.

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

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

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

	Three Months Ended June 30, 2014 $	Six Months Ended June 30, 2014 $	Three Months Ended June 30, 2013 $	Six Months Ended June 30, 2013 $
Income before income taxes and gain on disposal	–	–	2,261	11,661
Income taxes	(658)	(658)	(559)	(3,518)
(Loss) gain on disposal	–	–	153,274	153,274
Net income from discontinued operations	(658)	(658)	154,976	161,417
Cash flows from operating activities	–	–	4,225	8,494
Cash flows from financing activities	–	–	(67,086)	(49,231)
Cash flows from investing activities	–	–	(1,278)	(3,438)
Increase in cash	–	–	(64,139)	(44,175)

5. PROPERTY, PLANT AND EQUIPMENT

During the three and six months ended June 30, 2014, the Company sold non-core assets for $nil and $875, respectively. The carrying amount of the assets sold was $nil in the three months ended June 30, 2014 and $nil in the six months ended June 30, 2014 with a resulting gain on the sale of $875. During the three and six months ended June 30, 2013, the Company sold non-core assets for $217 and $3,800, respectively. The carrying amount of the assets sold in the three months ended June 30, 2013 was $970 with a resulting loss on the sale of $753. The carrying amount of the assets sold in the six months ended June 30, 2013 was $2,693 with a resulting gain of $1,107.

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

6. LONG-TERM DEBT

	Note	June 30, 2014 $	December 31, 2013 $
Credit facilities with lenders			
CHF 5,205, maturing 2020, unsecured		5,601	5,549
$107,816, interest up to 5.5%, maturing 2020, secured by the assets of the Fortress Specialty Cellulose mill	6(a)	107,527	105,107
Undrawn credit facility	6(b)	–	–
Unsecured convertible debentures			
$40,250 principal, interest at 6.5%, maturing 2016		36,509	35,872
$25,000 principal, interest at 7%, maturing 2017		23,241	22,997
$69,000 principal, interest at 7%, maturing 2019		59,250	58,605
		232,128	228,130
Less: Current portion		(14,865)	(14,572)
Long-term debt		217,263	213,558

	June 30, 2014 $	December 31, 2013 $
Principal value of debt	248,333	247,061
Unamortized borrowing costs and amounts allocated to equity for convertible debentures	(16,205)	(18,931)
Net amount recorded in liabilities	232,128	228,130

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

At June 30, 2014, the fair value of the long-term debt, measured at its amortized cost of $232,128 was $188,451. The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

(a) The lender has agreed with the Company to defer $5,147 and $10,445 in planned principal and interest for the three and six months ended June 30, 2014, respectively, without penalty. The facility is due in equal quarterly instalments up to June 30, 2020. Additionally, the lender has agreed to defer $4,888 in principal and interest for the three month period ended September 30, 2014, without penalty.

(b) The credit agreement is a facility for up to $132,400, granted to Fortress Global Cellulose to support the conversion to a dissolving pulp mill and is secured by the assets of Fortress Global Cellulose. The loan is repayable ten years after the first draw on the facility. At June 30, 2014, $nil has been drawn on this facility. Borrowing costs of $4,337 have been deferred and recorded as a prepaid expense until the loan is drawn upon.

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

7. SHARE CAPITAL

Authorized

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

Issued and fully paid — common shares

	Note	Number of Shares	Share Capital $
Balance, December 31, 2012		14,495,075	178,052
Restricted share units vested	8	66,570	1,619
Options exercised	8	24,448	369
Balance, December 31, 2013		14,586,093	180,040
Restricted share units vested	8	29,109	656
Deferred share units vested	8	–	–
Balance, June 30, 2014		14,615,202	180,696

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 June 30, 2014.

8. STOCK-BASED COMPENSATION

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, 2012	690,725	11.22
Forfeited	(40,000)	15.41
Balance December 31, 2013	650,725	10.96
Expired	(60,000)	15.41
Balance, June 30, 2014	590,725	10.51

During the six months ended June 30, 2014, 60,000 vested options expired.

As at June 30, 2014, 590,725 stock options were exercisable (December 31, 2013: 650,725). The stock options issued have various vesting dates that range from immediately to five years from the grant dates.

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

Deferred Share Unit Awards

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

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

	Number of DSUs	Expense recognized $
Balance, December 31, 2012	149,670	5,805
Granted	34,990	290
Vested	(24,448)	–
Balance, December 31, 2013	160,212	6,095
Granted	24,899	96
Balance, June 30, 2014	185,111	6,191

Restricted Share Unit Awards

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

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

	Number of RSUs
Balance, December 31, 2012	201,202
Granted	97,183
Vested	(66,570)
Forfeited	(11,209)
Balance, December 31, 2013	220,606
Granted	71,455
Vested	(29,109)
Cancelled	(15,932)
Balance, June 30, 2014	247,020

9. COMMITMENTS

As at June 30, 2014, the Company has committed to purchase $3.8 million in property, plant, and equipment.

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

As at June 30, 2014, the Company has performance bonds in the amounts of EUR 11,268.

As at June 30, 2014, the Company has committed to purchase steam from a supplier up to the end of 2015 for CHF 900 per year.

10. SEGMENTED INFORMATION

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

	Three months ended June 30, 2014			
	Security $	Pulp $	Corporate $	Fortress Paper Consolidated $
Sales	28,846	38,416	–	67,262
Operating income (loss)	(2,666)	(9,170)	(1,011)	(12,847)
Amortization[1]	(2,258)	(4,961)	–	(7,219)
Stock-based compensation[1]	–	–	366	366
Capital expenditures	562	2,712	–	3,274
Total assets	148,579	376,057	36,555	561,191

Sales by geographic area	%
Europe	6.4
Asia	65.7
Other	27.9
Total	100.0

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

	Three months ended June 30, 2013					
	Security $	Pulp $	Corporate $	Continuing Operations $	Discontinued Operations (Wallpaper) $	Fortress Paper Consolidated $
Sales	30,540	29,343	–	59,883	15,628	75,511
Operating income (loss)	(1,392)	(8,828)	(3,076)	(13,296)	3,422	(9,874)
Amortization[1]	(1,932)	(2,349)	–	(4,281)	–	(4,281)
Stock-based compensation[1]	–	–	(659)	(659)	–	(659)
Capital expenditures	584	13,957	–	14,541	1,507	16,048
Total assets	138,826	383,064	135,640	657,530	–	657,530

Sales by geographic area	%	%	%
Europe	4.6	97.9	23.9
Asia	79.9	1.2	63.6
Other	15.5	0.9	12.5
Total	100.0	100.0	100.0

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

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

	Six months ended June 30, 2014			
	Security	Pulp	Corporate	Fortress Paper Consolidated
	$	$	$	$
Sales	67,420	53,698	–	121,118
Operating income (loss)	(1,673)	(28,530)	(2,833)	(33,036)
Amortization[1]	(4,479)	(9,065)	–	(13,544)
Stock-based compensation[1]	–	–	128	128
Capital expenditures	762	3,980	–	4,742
Total assets	148,579	376,057	36,555	561,191

Sales by geographic area	%
Europe	5.6
Asia	68.5
Other	25.9
Total	100.0

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

	Six months ended June 30, 2013					
	Security	Pulp	Corporate	Continuing Operations	Discontinued Operations (Wallpaper)	Fortress Paper Consolidated
	$	$	$	$	$	$
Sales	59,213	58,229	–	117,442	57,730	175,172
Operating income (loss)	(5,514)	(19,854)	(6,352)	(31,720)	13,211	(18,509)
Amortization[1]	(3,917)	(4,698)	–	(8,615)	(745)	(9,360)
Stock-based compensation[1]	–	–	(1,587)	(1,587)	–	(1,587)
Capital expenditures	1,003	32,977	–	33,980	3,652	37,631
Total assets	138,826	383,064	135,640	657,530	–	657,530

Sales by geographic area	%	%	%
Europe	3.1	96.6	33.9
Asia	85.0	3.1	58.0
Other	11.9	0.3	8.1
Total	100.0	100.0	100.0

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