FORTRESS PAPER LTD.

Q1 2010

FOR THE THREE MONTHS ENDED

MARCH 31, 2010

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 three month period ended March 31, 2010 (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 March 31, 2010 relative to the previous quarter and prior year comparative quarter.

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

Throughout this discussion, reference is 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 May 9, 2010.

All financial references are in Canadian dollars unless otherwise noted.

Highlights

Fortress reported adjusted net income of $3.0 million for the first quarter of 2010 on sales of $50.3 million or adjusted earnings per share of $0.30. In the first quarter of 2009 the Company reported adjusted net income of $2.5 million on sales of $46.6 million or adjusted earnings per share of $0.25. For the fourth quarter of 2009 the Company reported adjusted net income of $4.8 million on sales of $51.0 million or adjusted earnings per share of $0.47.

Analysis of Specific Items Affecting Comparability of Net Income

(thousands of dollars, except per share figures, unaudited)	**Q1 2010**	**Q4 2009**	**Q1 2009**
Net income as reported	179	3,720	3,584
Foreign exchange loss (gain)	2,380	1,073	(1,055)
Deferred expenses written off	476	-	-
Adjusted net income	3,035	4,793	2,529
Net income per share (EPS), as reported	0.02	0.35	0.35
Impact of above item per share	0.28	0.12	(0.10)
Adjusted net income per share	0.30	0.47	0.25

EBITDA was $5.8 million or 11.5% of sales for the three months ended March 31, 2010. For the three months ended March 31, 2009 EBITDA was $5.0 million or 10.8% of sales. EBITDA for the fourth quarter of 2009 was $7.9 million or 15.4% of sales.

In the first quarter of 2010 the Dresden mill continued to experience strong sales and earnings throughout the quarter. The Landqart mill results reflected the product mix during the quarter. The banknote paper machine remains full and the conversion of paper machine one from a specialty paper machine to a banknote paper machine is on track. The increase in EBITDA relative to the prior year comparative period was partially due to the global financial and economic crisis which impacted sales early in 2009.

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.

First Quarter 2010 Earnings Review

Three Months Ended March 31, 2010

Selected Financial Information and Statistics

(thousands of dollars, except per unit amounts and shipments, unaudited)	**Q1 2010**	**Q4 2009**	**Q1 2009**
Sales	50,304	51,049	46,623
EBITDA[1]	5,809	7,885	5,032
Operating income	4,202	6,292	3,765
Net income	179	3,720	3,584
Shipments (tonnes)	16,386	15,291	12,723

[1]See net income to EBITDA reconciliation.

Overview

Landqart produces various security and specialty papers. Security paper production includes banknote paper 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 quarter ended March 31, 2010 is approximately 1,581 tonnes of non-woven wallpaper base. At the Landqart mill the order log for security papers remains stable.

At the Dresden mill, the wallpaper base market experienced continued strength throughout the quarter. Sales tonnage has increased relative to the prior year comparative periods and profitability remains solid.

Sales. Sales for the three months ended March 31, 2010 were higher relative to the first quarter of 2009 primarily due to the global economic crisis which impacted our results in the prior year comparative period. Sales for the three months ended March 31, 2010 were slightly lower when compared to the previous quarter due primarily to the EUR and CHF depreciation relative to the CAD.

Cost of Products Sold. Cost of products sold were $38.6 million or 76.7% of sales for the three months ended March 31, 2010 compared to $36.1 million or 77.4% in the prior year comparative period. In the fourth quarter of 2009, cost of products sold were $37.3 million or 73.0% of sales.

Selling, General and Administrative. Selling, general and administrative expenses were $5.9 million for the first quarter of 2010 (first quarter 2009, $5.5 million and fourth quarter 2009 $5.9 million). Included in selling, general and administrative expenses for the first quarter of 2010 were $0.5 million related to previous deferred expenses that were written off.

Stock-based Compensation. Stock-based compensation expense was $0.2 million during the period ($0.2 million and $0.2 million in the first quarter of 2009 and the fourth quarter of 2009, respectively).

Stock-based compensation expense was $0.2 million during the period (Q4 2009)

EBITDA. As a result of the foregoing factors, EBITDA was $5.8 million in the first quarter of 2010 compared to $5.0 million in the first quarter of 2009 and $7.9 million in the fourth quarter of 2009.

Net income to EBITDA reconciliation:

(thousands of dollars, unaudited)	Q1 2010	Q4 2009	Q1 2009
Net income	$179	$3,720	$3,584
Income tax	1,462	1,199	1,044
Foreign exchange (gain) loss	2,380	1,073	(1,055)
Interest expense	181	300	192
Amortization	1,388	1,441	1,067
Stock based compensation	218	152	200
EBITDA	$5,808	$7,885	$5,032

Operating Results by Business Segment

Landqart Mill

(thousands of dollars, except for shipments, unaudited)	Q1 2010	Q4 2009	Q1 2009
Sales	19,111	19,464	20,361
Operating income	646	2,183	840
Shipments (tonnes)	4,287	3,673	3,721

Dresden Mill

(thousands of dollars, except for shipments, unaudited)	Q1 2010	Q4 2009	Q1 2009
Sales	31,193	31,585	26,262
Operating income	5,326	5,110	4,034
Shipments (tonnes)	12,099	11,618	9,002

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.

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 March 31, 2010 was $24.8 million (December 31, 2009 - $33.2 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 87% 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 $0.3 million and is considered collectable. The Company's trade receivable balance at March 31, 2010 was $16.5 million (December 31, 2009 - $18.0 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 March 31, 2010, the Company's accounts payable and accrued liabilities totaled $23.5 million (December 31, 2009 - $22.4 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.

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.

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 used cash of $2.5 million in the first quarter of 2010 compared to $4.5 in the first quarter of 2009. In the fourth quarter of 2009, operating activities generated $14.0 million.

Working capital is subject to cyclical operating needs, the timing of collection of receivables and the payment of payables and expenses. The CHF/CAD and Euro/CAD exchange rates were 0.9646 and 1.3737, respectively, as at March 31, 2010 compared to a CHF/CAD rate of 1.0107 and a Euro/CAD rate of 1.5000 as at December 31, 2009.

Investing Activities

Investing activities in the first quarters of 2010 and 2009 used cash of $10.8 million and $2.0 million, respectively. Investing activities in the fourth quarter of 2009 used cash of $6.1 million. Investment activities relate primarily to the purchase of plant and equipment at the mills

Financing Activities

In the first quarter of 2010, financing activities generated $6.4 million related to loan proceeds of $6.8 million partially offset by $0.1 million repayment of capital lease and $0.3 million loan repayment. In the first quarter and fourth quarter of 2009, financing activities used cash of $0.2 million and $6.1, respectively, for repayment of loans and capital lease.

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.

Outstanding Shares

The number of common shares outstanding at March 31, 2010 and the date of this report was 10,233,500. The number of options outstanding at March 31, 2010 and the date of this report was 740,175. At March 31, 2010 and the date of this report there were 168,795 restricted share units. At March 31, 2010 and the date of this report there were 30,255 and 31,567 deferred share units outstanding, respectively.

Critical Accounting Estimates

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

Changes in Accounting Policies

Current Year

Effective January 1, 2010, the Company retroactively changed their accounting policy to allow for the capitalization of interest for borrowings related to the construction of property, plant and equipment. This change in policy did not significantly impact the consolidated financial statements for prior years.

Prior Year

Effective January 1, 2009, the Company adopted the Canadian Institute of Chartered Accountants' new 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. The adoption of this new policy did not significantly impact the consolidated financial statements.

Future Changes in Accounting Policy

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.

Disclosure Controls and Internal Controls Over Financial Reporting

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board of Directors and the Audit Committee. The Company's chief executive officer ("CEO") and chief financial officer ("CFO") have evaluated the effectiveness of these disclosure controls and procedures for the year ending December 31, 2009 and the quarter ending March 31, 2010, and have concluded that they are effective.

During the quarter ending March 31, 2010, 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.

Conversion to International financial reporting standards (IFRS)

On February 13, 2008, the Accounting Standards Board announced that publicly accountable entities will be required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS) for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The Company will rely mainly on internal resources to ensure compliance with IFRS. The Company intends to convert to these new standards according to the timetable set for these new rules.

The Company has formally established a transition plan and project implementation team. The project team consists initially of members from Finance. Reporting is done to senior management and to the Audit Committee on a quarterly basis.

The Company has substantively completed the detailed diagnostic plan which included identifying significant accounting policy differences and their related areas of impact in terms of systems, procedures and financial statements. Differences between IFRS and Canadian generally accepted accounting principles (GAAP), in addition to those referenced below, may continue to be identified based on further detailed analysis by the Company and other changes to IFRS prior to the Company's conversion to IFRS in 2011. The Company will continue to review all proposed and continuing projects of the International Accounting Standards Board to determine their impact and will continue to invest in training and resources throughout the transition period to facilitate a timely conversion.

Set out below are some of the key areas where changes in accounting policies are expected that may materially impact the Company's consolidated financial statements. The list and comments should not be regarded as a complete list of changes that will result from a transition to IFRS. It is intended to highlight the more significant areas we have identified to date. Analysis of changes is still in process and not all decisions have been finalized where choices of accounting policies are available.

Accounting Policy Impact and Decisions

Employee Benefits

IAS 19, "Employee Benefits", permits a Company to recognize actuarial gains and losses immediately in other comprehensive income rather than amortized through earnings. IFRS 1 also provides an option to recognize immediately in equity all cumulative actuarial gains and losses existing as at the date of transition to IFRS. The Company currently plans on taking the exemption under IFRS 1.

Property, Plant and Equipment

IFRS 1 permits a Company to revalue individual items of property, plant and equipment at their fair value as at the date of transition to IFRS. The Company is currently evaluating this option.

Business Combinations

IFRS 1 provides an exemption that allows Companies transitioning to IFRS to not restate business combinations entered into prior to the date of transition. The Company currently plans to take this exemption.

Provisions

IAS 37, "Provisions, Contingent Liabilities and Contingent Assets", requires a provision to be recognized when there is a present obligation as a result of a past transaction or event; it is probable that an outflow of resources will be required to settle the obligation; and a reliable estimate can be made of the obligation. The threshold of "probable" is a lower threshold than "likely", which is used in Canadian GAAP. Therefore, it is possible that there may be some contingent liabilities which would meet the recognition criteria under IFRS that were not recognized under Canadian GAAP. Other differences between IFRS and Canadian GAAP exist in relation to the measurement of provisions, such as the methodology for determining the best estimate where there is a range of equally possible outcomes (IFRS uses the mid-point of the range, whereas Canadian GAAP uses the low-end of the range), and the requirement under IFRS for provisions to be discounted where material.

Subsequent Events

On April 30, 2010 the Company completed the purchase of a northern bleached hardwood kraft pulp mill located in Thurso, Quebec from Fraser Papers Inc. through a wholly-owned subsidiary, Fortress Specialty Cellulose Inc. ("Fortress Specialty Cellulose"), for the net proceeds of approximately $1.2 million. The Company has announced the intention of converting this mill into a specialty cellulose (dissolving pulp) operation and to build a biomass-based cogeneration plant. The valuation of this acquisition for accounting purposes and the effect on the financial statements of the Company are still being determined.

Concurrent with this acquisition the Company finalized $102.4 million in project financing with a term of 10 years secured by the assets of Fortress Specialty Cellulose. Interest will be calculated at a fixed rate of 5.0% per annum for the first five years, followed by a rate of up to 5.5% for the remaining 5 years.

Also concurrent with this acquisition Fortress Paper issued a $15 million convertible debenture to a financial institution. The convertible debt matures in five years with an interest rate of 7% per annum. The debenture is convertible, in whole or in part, at the option of the holder into common shares of Fortress Paper at any time at a conversion price equal to $20.00 per share. Fortress Paper can redeem the debenture, in whole or in part, at any point after two years at a conversion price of not less than $25.00 per share.

Management's Outlook

This is an exciting time for the Company. The recently announced acquisition of the Thurso mill will diversify the specialty product mix which the Company believes will provide a significant financial contribution to Fortress's growth aspirations. Fortress plans to ramp up operations at the Thurso mill while immediately beginning the conversion of the mill into a dissolving pulp operation. The Dresden mill continues to perform extremely well, while the Landqart mill is experiencing results which are reflective of the current product mix of banknotes which offer lower margins.

Risks and Uncertainties

A comprehensive discussion of Risk Factors is included in the Company's 2009 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)	Q1 2010	Q4 2009	Q3 2009	Q2 2009
Sales	50,304	51,049	51,000	49,638
Operating income	4,202	6,292	5,198	4,460
EBITDA	5,809	7,885	6,967	5,699
Net income	179	3,514	3,467	1,926
Basic EPS	\$0.02	\$0.36	\$0.34	\$0.19
Diluted EPS	\$0.02	\$0.35	\$0.34	\$0.19
Weighted average shares outstanding Basic (thousands)	10,234	10,234	10,234	10,234
Weighted average shares outstanding Diluted (thousands)	10,713	10,487	10,296	10,234
Average Swiss/Canadian exchange rate(1)	0.9832	1.0341	1.0335	1.0498
Average Euro/Canadian exchange rate (1)	1.4381	1.5600	1.5699	1.5891

(thousands of dollars, except per unit amounts, earnings per share ("EPS"), exchange rates and shares outstanding, unaudited)	Q1 2009	Q4 2008	Q3 2008	Q2 2008
Sales	46,623	46,331	43,744	49,138
Operating income	3,765	4,399	4,993	5,075
EBITDA	5,032	5,966	6,234	6,184
Net income	3,584	2,778	2,312	3,401
Basic EPS	\$0.35	\$0.27	\$0.22	\$0.33
Diluted EPS	\$0.35	\$0.27	\$0.22	\$0.33
Weighted average shares outstanding Basic (thousands)	10,234	10,235	10,302	10,248
Weighted average shares outstanding Diluted (thousands)	10,234	10,235	10,471	10,423
Average Swiss/Canadian exchange rate(1)	1.0845	1.0470	0.9699	0.9797
Average Euro/Canadian exchange rate (1)	1.6226	1.5960	1.5623	1.5778

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

FORTRESS PAPER LTD.
CONSOLIDATED BALANCE SHEETS
(Canadian dollars, amounts in thousands)

	As at March 31, 2010	As at December 31, 2009
ASSETS		
Current		
Cash and cash equivalents	$ 24,813	$ 33,205
Trade accounts receivable	16,481	18,034
Other accounts receivable	5,426	2,614
Inventories	27,743	26,880
Prepaid expenses	501	873
	74,964	81,606
Restricted cash	42	45
Deferred expenses	1,053	476
Property, plant and equipment	57,550	47,852
Employee future benefits *(note 3)*	9,604	9,888
Total assets	$ 143,213	$ 139,867
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	$ 23,503	$ 22,447
Income taxes payable	1,495	4,446
Current portion of long-term debt *(note 4)*	4,827	5,378
	29,825	32,271
Long-term debt *(note 4)*	24,376	18,984
Future income taxes	2,031	2,028
Total liabilities	$ 56,232	$ 53,283
Shareholders' equity *(note 5)*		
Share capital	59,083	59,083
Contributed surplus	3,306	3,088
Retained earnings	24,592	24,413
Total shareholders' equity	86,981	86,584
Total liabilities and shareholders' equity	$ 143,213	$ 139,867

Commitments *(note 10)*
Subsequent events *(note 11)*

(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)
(Canadian dollars, amounts in thousands)

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Sales	$ 50,304	$ 46,623
Costs and expenses		
Cost of products sold	38,572	36,063
Amortization	1,388	1,067
Selling, general and administration	5,924	5,528
Stock-based compensation *(note 6)*	218	200
Operating income	4,202	3,765
Other income (expense)		
Interest, net	(181)	(192)
Foreign exchange (loss) gain	(2,380)	1,055
Net income before income taxes	1,641	4,628
Income tax expense	(1,462)	(1,044)
Net income and comprehensive income	$ 179	$ 3,584
Earnings per share		
Basic	$ 0.02	$ 0.35
Diluted	$ 0.02	$ 0.35
Weighted average number of shares outstanding		
Basic	10,233,500	10,233,500
Diluted	10,712,676	10,233,500

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Retained earnings		
Balance — beginning of period	$ 24,413	$ 11,716
Earnings	179	3,584
Balance — end of period	$ 24,592	$ 15,300
Accumulated other comprehensive earnings		
Balance — beginning and end of period	$ –	$ –

(See accompanying notes)

FORTRESS PAPER LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Canadian dollars, amounts in thousands)

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Cash flows from operating activities		
Net income	$ 179	$ 3,584
Items not affecting cash:		
Amortization	1,389	1,067
Future income taxes	3	(94)
Foreign exchange gain on long term debt	(1,631)	(1,066)
Foreign exchange loss on cash and cash equivalents	1,533	236
Stock based compensation	218	200
	1,691	3,927
Change in non-cash working capital items		
Trade accounts receivable	(1,259)	(6,682)
Inventory	(863)	90
Prepaid expenses	371	(36)
Other assets	284	500
Accounts payable and accrued liabilities	273	(641)
Income taxes payable	(2,951)	(1,643)
	(2,454)	(4,485)
Cash flows from financing activities		
Repayment of long-term debt	(279)	(187)
Proceeds from long-term debt , net of transaction costs	6,752	81
Payment on capital leases	(101)	(79)
	6,372	(185)
Cash flows from investing activities		
Additions to property, plant and equipment	(10,203)	(1,649)
Deferred expenses	(577)	(311)
Restricted cash	3	–
	(10,777)	(1,960)
Decrease in cash position	(6,859)	(6,630)
Foreign exchange loss on cash and cash equivalents	(1,533)	(236)
Cash and cash equivalents, beginning of period	33,205	26,187
Cash and cash equivalents, end of period	$ 24,813	$ 19,321

Supplementary cash flow information *(note 9)*

(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. From the date of incorporation to July 31, 2006 the Company was inactive. The Company's fiscal year end is December 31. Fortress owns and operates two paper mills, the Landqart mill located in Switzerland and the Dresden mill located in Germany. 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.

These unaudited interim financial statements do not include all of the disclosures required by Canadian generally accepted accounting principles 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, 2008 (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, 2009 consolidated financial statements except as disclosed in Note 2.

2. CHANGE IN ACCOUNTING POLICIES

Current Year

Effective January 1, 2010, the Company retroactively changed their accounting policy to allow for the capitalization of interest for borrowings related to the construction of property, plant and equipment. This change in policy did not significantly impact the consolidated financial statements for prior years.

Prior Year

Effective January 1, 2009, the Company adopted the Canadian Institute of Chartered Accountants' new 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. The adoption of this new policy did not significantly impact the consolidated financial statements.

Future Changes in Accounting Policy

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.

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

3. EMPLOYEE FUTURE BENEFITS

Defined benefit pension expenses of $120 were recorded for the three months ended March 31, 2010. Defined benefit pension expenses of $399 were recorded for the three months ended March 31, 2009.

4. LONG-TERM DEBT AND OPERATING LOANS

Long-term debt

	March 31, 2010	December 31, 2009
Credit agreement with bank maturing and 2013; interest at 2.65% secured by current assets (EUR 3,073 and 2009 - EUR 3,233)	$ 4,222	$ 4,835
Credit agreement with lender maturing 2018; interest at 6.2% and 7.1% secured by fixed assets (EUR 5,100 and 2009 - nil) (a)	6,424	–
Credit agreement with bank maturing 2012; interest at 4.8% unsecured (CHF 4,710 and 2009 – CHF 4,710)	4,543	4,760
Credit agreement with bank maturing 2011, 2013 and 2018; interest up to 3.1% and 4.9% secured by fixed assets (CHF 14,130 and 2009 – CHF 14,130)	13,629	14,281
Capital leases; interest at 4.0% (EUR 280 and 2009 - EUR 324)	385	486
	29,203	24,362
Less: Current portion	(4,827)	(5,378)
	$ 24,376	$ 18,984

(a) The credit agreement is a facility for up to EUR 18.5 million of which EUR 5.1 million has been drawn as at March 31, 2010. The facility bears interest at a rate of 6.2% up until the commercial production of the rebuilt paper machine at the Landqart facility. At the time of commercial production the loan is repayable in equal installments over 7 years and bears interest at a rate of 7.1%.

Transaction costs of $577 have been netted against the proceeds of the loan. Interest has been calculated at 7.6% using the effective interest rate method.

5. SHAREHOLDERS' EQUITY

(a) **Authorized:**

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

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

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

	Number of Shares	Share Capital	Contributed Surplus
Balance, December 31, 2008	10,233,500	$ 59,083	$ 2,107
Stock compensation	—	—	981
Balance, December 31, 2009	10,233,500	$ 59,083	$ 3,088
Stock compensation	—	—	218
Balance, March 31, 2010	10,233,500	$ 59,083	$ 3,306

6. STOCK BASED COMPENSATION

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

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

Stock Options

In June 2009, options were granted for 35,000 shares which vest over two years to an employee and officer of the Company. The weighted average fair vale of the options granted during 2009 was estimated at $2.98 per option (2008 - $2.57) at the grant date 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 were as follows:

	2009	2008
Risk free interest rate	1.78%	4%
Expected life of options	5 years	5 years
Annualized volatility	53%	40%
Dividend rate	Nil	Nil

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

	Number of options	Exercise Price
Balance, December 31, 2008	1,012,675	$ 8.00

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

Forfeiture May 25, 2009	(25,000)	8.00
Cancelled June 10, 2009	(282,500)	8.00
Granted June 23, 2009	35,000	8.00
Balance, December 2009 and March 31, 2010	740,175	$ 8.00

As at March 31, 2010, 486,842 stock options were exercisable (December 31, 2009 – 486,842). No stock options were exercised during the quarter ended March 31, 2010, or during the year ended December 31, 2009. The stock options issued have various vesting dates which range from one to three years from the IPO or grant dates. The weighted average remaining expected life of the stock options issued as at March 31, 2010 is 2.5 years. The Company recorded $64 stock compensation expense and contributed surplus for the three months ended March 31, 2010 and $201 for the three months ended March 31, 2009.

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. On March 19, 2010, non-employee directors were awarded 4,255 units in aggregate. The Company recorded $60 stock compensation expense and contributed surplus for the three months ended March 31, 2010 (2009 - $nil). At March 31, 2010 there were 30,255 units outstanding.

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 years. The Company recognizes the expense on a straight-line basis over the vesting period. On March 19, 2010 restricted shares of 11,169 units were awarded to key employees. For the three months ended March 31, 2010, $95 was recorded as stock compensation expense and contributed surplus (2009 - $nil). As at March 31, 2010, the total remaining unrecognized compensation cost related to RSUs amounted to $1,089, which will be amortized over their remaining vesting period.

7. FINANCIAL INSTRUMENTS

The Company had committed to buying a total of USD 750 over various dates between April, 2009 and June, 2009 at EUR/USD foreign exchange rates ranging from 1.4588 and 1.4644. The Company had unrealized gains of $88 as at March 31, 2009 related to foreign exchange rate contracts as a result of recording these forward contracts at market value. There were no forward foreign exchange rate contracts as at March 31, 2010.

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

8. 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 Landqart mill produces specialty and security papers while the Dresden mill produces non-woven wallpaper base products. During the period ended March 31, 2010, the Company earned revenue from one customer representing approximately 11% of sales. During the period ended March 31, 2009, the Company earned revenue from two customers each representing approximately 12% of sales.

	Three months ended March 31, 2010			
	Dresden Mill (Germany)	**Landqart Mill** (Switzerland)	**Corporate** (Canada)	**Fortress Paper Consolidated**
Sales	$ 31,193	19,111	—	$ 50,304
Operating earnings (loss)	$ 5,326	646	(1,770)	$ 4,202
Amortization	$ (579)	(809)	—	$ (1,388)
Stock-based compensation[1]	$ —	—	(218)	$ (218)
Capital expenditures	$ 2,309	8,778	—	$ 11,087
Property, plant and equipment	$ 21,935	35,615	—	$ 57,550
Sales by geographic area	%	%		%
Germany	41.3	28.0		36.2
Switzerland	—	10.8		4.1
Other Western Europe	28.0	43.3		33.8
Eastern Europe	28.6	7.0		20.4
Other	2.1	10.9		5.4
Total	100.0	100.0	—	100.0

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

	Three months ended March 31, 2009			
	Dresden Mill (Germany)	**Landqart Mill** (Switzerland)	**Corporate** (Canada)	**Fortress Paper Consolidated**
Sales	$ 26,262	20,361	—	$ 46,623
Operating earnings (loss)	$ 4,034	840	(1,109)	$ 3,765
Amortization	$ (589)	(478)	—	$ (1,067)
Stock-based compensation[2]	$ —	—	(200)	$ (200)
Capital expenditures	$ 966	409	—	$ 1,375
Property, plant and equipment	$ 17,027	26,817	—	$ 43,844
Sales by geographic area	%	%		%
Germany	45.3	10.5		30.1
Switzerland	—	23.2		10.1
Other Western Europe	31.1	50.5		39.6
Eastern Europe	22.1	5.5		14.9
Other	1.5	10.3		5.3
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)

9. SUPPLEMENTARY CASH FLOW INFORMATION

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Interest paid	$ 318	$ 219
Income taxes paid	$ 4,157	$ 2,624

Non cash items

Non cash property, plant and equipment purchases included in accounts payable increased by $783 for the three months ended March 31, 2010 and decreased by $352 for the three months ended March 31, 2009.

10. COMMITMENTS

As at March 31, 2010, the Company has committed to purchase $21.9 million in property, plant and equipment over the next twelve months.

11. SUBSEQUENT EVENTS

On April 30, 2010 the Company completed the purchase of a northern bleached hardwood kraft pulp mill located in Thurso, Quebec from Fraser Papers Inc. through a wholly-owned subsidiary, Fortress Specialty Cellulose Inc. ("Fortress Specialty Cellulose"), for the net proceeds of approximately $1.2 million. The Company has announced the intention of converting this mill into a specialty cellulose (dissolving pulp) operation and to build a biomass-based cogeneration plant. The valuation of this acquisition for accounting purposes and the effect on the financial statements of the Company are still being determined.

Concurrent with this acquisition the Company finalized $102.4 million in project financing with a term of 10 years secured by the assets of Fortress Specialty Cellulose. Interest will be calculated at a fixed rate of 5.0% per annum for the first five years, followed by a rate of up to 5.5% for the remaining 5 years.

Also concurrent with this acquisition Fortress Paper issued a $15 million convertible debenture to a financial institution. The convertible debt matures in five years with an interest rate of 7% per annum. The debenture is convertible, in whole or in part, at the option of the holder into common shares of Fortress Paper at any time at a conversion price equal to $20.00 per share. Fortress Paper can redeem the debenture, in whole or in part, at any point after two years at a conversion price of not less than $25.00 per share.