FORTRESS PAPER LTD.

Q2 2009

FOR THE THREE AND SIX MONTHS ENDED

JUNE 30, 2009

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 and six month periods ended June 30, 2009 and with the audited consolidated financial statements for the year ended December 31, 2008 (available on SEDAR at www.sedar.com). The MD&A provides a review of the significant developments that have impacted the Company's performance during the quarter ended June 30, 2009 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 August 6, 2009.

All financial references are in Canadian dollars unless otherwise noted.

Highlights

Fortress Paper Ltd. reported net income of $1.9 million for the second quarter of 2009 on sales of $49.6 million or basic and diluted earnings per share of $0.19. For the second quarter of 2008 the Company reported net income of $3.4 million on sales of $49.1 million or basic and diluted earnings per share of $0.33. In the first quarter of 2009 the Company reported net income of $3.6 million on sales of $46.6 million or basic and diluted earnings per share of $0.35.

Included in net income for the second quarter of 2009 was a foreign exchange loss of $0.8 million. Included in net income for the second quarter of 2008 was a future income tax recovery of $1.1 million relating to the reduction of the combined tax rate in Landqart, Switzerland and a foreign exchange loss of $0.2 million. Included in net income for the first quarter of 2009 was a foreign exchange gain of $1.0.

EBITDA was $5.7 million or 11.5% of sales for the three months ended June 30, 2009. For the three months ended June 30, 2008 EBITDA was $6.2 million or 12.6% of sales. EBITDA for the first quarter of 2009 was $5.0 million or 10.8% of sales.

The decrease in EBITDA relative to the prior year comparative period was primarily due to the difficult environment for specialty papers at the Landqart mill which was a direct result of the global economic slowdown. The market for security papers, which includes bank notes, passport paper and other high security papers, continues to show strength and our order book for wallpaper base has recovered to healthy levels.

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.

Second Quarter 2009 Earnings Review

Three Months Ended June 30, 2009

Selected Financial Information and Statistics

(thousands of dollars, except shipments, unaudited)	**Q2 2009**	**Q1 2009**	**Q2 2008**
Sales	49,638	46,623	49,138
EBITDA[1]	5,699	5,032	6,184
Operating income	4,460	3,765	5,075
Net income	1,926	3,584	3,401
Shipments (tonnes)	14,181	12,723	14,125

[1]See net income to EBITDA reconciliation.

Operating Results by Business Segment

Landqart Mill

(thousands of dollars, except for shipments, unaudited)	**Q2 2009**	**Q1 2009**	**Q2 2008**
Sales	20,861	20,361	19,999
Operating income	28	840	822
Shipments (tonnes)	4,127	3,721	4,473

Dresden Mill

(thousands of dollars, except for shipments, unaudited)	**Q2 2009**	**Q1 2009**	**Q2 2008**
Sales	28,777	26,262	29,139
Operating income	5,477	4,034	5,245
Shipments (tonnes)	10,054	9,002	9,652

Overview

At the Landqart mill the market for security papers continues to show strength; however, specialty papers experienced a difficult second quarter as a direct result of the global economic slowdown.

At the Dresden mill, the wallpaper base market experienced strong orders throughout the second quarter which resulted in improved margins compared to the first quarter. Despite the global crisis, profitability remains strong and the order book has improved.

Sales. Sales for the three months ended June 30, 2009 were higher relative to the first quarter of 2009 primarily due to the recovery experienced at the Dresden mill. Sales for the three months ended June 30, 2009 were slightly higher when compared to the prior year comparative quarter.

Cost of Products Sold. Cost of products sold were $38.6 million or 77.8% of sales for the three months ended June 30, 2009 compared to $37.1 million or 75.6% in the prior year comparative period. In the first quarter of 2009, cost of products sold were $36.1 million or 77.4% of sales.

Selling, General and Administrative. Selling, general and administrative expenses were $5.3 million (second quarter 2008, $5.8 million and first quarter 2009, $5.5 million) and were comprised primarily of sales commissions, marketing, corporate and administrative expenses.

EBITDA. As a result of the foregoing factors, EBITDA was $5.7 million in the second quarter of 2009 compared to $6.2 million in the second quarter of 2008 and $5.0 million in the first quarter of 2009.

Net income to EBITDA reconciliation:

(thousands of dollars, unaudited)	**Q2 2009**	**Q1 2009**	**Q2 2008**
Net income	$1,926	$3,584	$3,401
Income tax	1,511	1,044	517
Foreign exchange (gain) loss	766	(1,055)	170
Interest expense	257	192	987
Amortization	1,029	1,067	733
Stock based compensation	210	200	376
EBITDA	$5,699	$5,032	$6,184

Six Months Ended June 30, 2008

Selected Financial Information and Statistics for the Six Months Ended:

(thousands of dollars, except for shipments, unaudited)	**June 30, 2009**	**June 30, 2008**	**June 30, 2007**
Sales	96,261	98,927	73,692
EBITDA[1]	10,731	12,827	7,160
Operating income	8,225	10,602	5,812
Net income	5,510	7,590	2,794
Shipments (tonnes)	26,904	29,129	26,048

[1]See net income to EBITDA reconciliation.

Overview

At the Landqart mill the market for security papers continues to show strength; however, specialty papers experienced a difficult six month period ended June 30, 2009 as a direct result of the global economic slowdown.

At the Dresden mill, the wallpaper base market experienced strengthening orders through the first half of 2009. Despite the global crisis, profitability remains strong and the order book strengthened.

Sales. Sales for the six months ended June 30, 2009 were slightly lower relative to prior year comparative period primarily due to due to the product mix change at the Dresden mill and a challenging period for specialty papers at the Landqart mill which were a direct result of the global economic slowdown.

Cost of Products Sold. Cost of products sold were $74.7 million or 77.6% of sales for the six months ended June 30, 2009. In the six months ended June 30, 2008 cost of products sold were $75.3 million or 76.1%. Security and wallpaper base operated at full capacity during the period.

Selling, General and Administrative. Selling, general and administrative expenses were $10.8 million for the six months ended June 30, 2009 and $10.8 million in the prior year comparative period.

Stock-based Compensation. Stock-based compensation expense was $0.4 million during the period (prior year comparative period, $0.8 million).

EBITDA. As a result of the foregoing factors, EBITDA was $10.7 million for the six months ended June 30, 2009 compared to $12.8 for the six months ended June 30, 2008.

Net income to EBITDA reconciliation:

(thousands of dollars, unaudited)	June 30, 2009	June 30, 2008	June 30, 2007
Net income	$5,510	$7,590	$2,794
Income tax	2,555	2,647	1,602
Other (income) expense	(289)	(773)	361
Interest expense	449	1,138	1,055
Amortization	2,096	1,473	848
Stock based compensation	410	752	500
EBITDA	$10,731	$12,827	$7,160

Operating Results by Business Segment

Landqart Mill

(thousands of dollars, except for shipments, unaudited)	June 30, 2009	June 30, 2008	June 30, 2007
Sales	41,222	40,724	32,920
Operating income	868	1,572	2,362
Shipments (tonnes)	7,848	9,076	8,266

Dresden Mill

(thousands of dollars, except for shipments, unaudited)	June 30, 2009	June 30, 2008	June 30, 2007
Sales	55,039	58,203	40,772
Operating income	9,511	10,977	4,406
Shipments (tonnes)	19,056	20,053	17,782

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 will be subject to future economic conditions and the financial success of Fortress' business and other factors, many of which are not within Fortress' control, including changes in market prices for its security and specialty papers and raw material costs.

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

(thousands of dollars, except for shipments, unaudited)	June 30, 2009	December 31, 2008
Cash and cash equivalents	$ 24,899	$ 26,187
Less total debt	(32,736)	(30,591)
Net debt	$ (7,837)	$ (4,404)
Shareholders' equity	$ 78,825	$ 72,906

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

Credit Risk

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

Cash and cash equivalents includes cash on deposit with an original maturity date of 90 days or less. In order to mitigate the risk of financial loss, cash on deposit is held with major Canadian and international financial institutions. The cash and cash equivalents balance at June 30, 2009 was $24.9 million (December 31, 2008 was $26.2 million). The Company does not have holdings in asset backed commercial paper.

The Company utilizes credit insurance to manage the risk associated with trade receivables. Approximately 89% 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 $0.4 million and is considered collectable. The Company's trade receivable balance at June 30, 2009 was $28.2 million (December 31, 2008 was $18.1 million). This increase in accounts receivable is directly related to the cancellation of a factoring arrangement at the Dresden mill as well as increased sales.

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 $0.7 million in the six month ended June 30, 2009 compared to cash generation of $9.6 million in the six months ended June 30, 2008. This change is primarily due to increased trade receivables directly related to the cancellation of a factoring arrangement at the Dresden mill.

In the second quarter of 2009, operating activities generated $3.8 million compared to $7.6 million in the prior year comparative period.

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 1.0697 and 1.6297 respectively as at June 30, 2009 compared to a CHF/CAD rate of 1.1472 and a Euro/CAD rate of 1.7046 as at December 31, 2008.

Investing Activities

Investing activities in the six months ended June 30, 2009 used cash of $3.5 million related to the purchase of plant and equipment at the mills and $0.5 million in deferred expenses. In the six months ended June 30, 2008 investing activities used cash of $6.4 million related to the purchase of plant and equipment at the mills.

Investing activities in the second quarter of 2009 and 2008 used cash of $2.0 million and $4.3 million, respectively, primarily related to the purchase of plant and equipment at the mills.

Financing Activities

Financing activities in the six months ended June 30, 2009 provided cash of $4.0 million primarily related to $6.0 million in additional financing partially offset by the repayment of debt ($2.0 million). In the six months ended June 30, 2008, financing used cash of $12.1 million primarily related to the redemption of the convertible note ($8.2 million) and repayment of debt and operating loans ($8.0 million) partially offset by $4.1 million in additional financing.

Financing activities in the second quarter of 2009 provided cash of $4.1 million related to $5.9 million in additional financing partially offset by the repayment of long term debt ($1.8 million). In the prior year comparative period financing activities used cash of $7.3 million primarily related to the redemption of the convertible note ($8.2 million) and repayment of long term debt ($1.5 million) partially offset by 2.4 million in additional financing.

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

Related Party Transactions

There were no transactions with related parties during the six month period ended June 30, 2009. In the six month period ended June 30, 2008, the Company has paid or accrued office and administration expenses of $38 to a Company with a common director.

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

Foreign Currency

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

Outstanding Shares

The number of common shares outstanding at June 30, 2009 and the date of this report was 10,233,500. The number of options outstanding at June 30, 2009 and the date of this report was 740,175.

Critical Accounting Estimates

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

Changes in Accounting Policies

Effective January 1, 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.

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 and has completed the following steps:

- 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 regular basis.

- Completed the first phase of its transition program, which included scoping to identify the significant accounting policy differences and their related areas of impact in terms of systems, procedures and financial statements.

- Commenced the second phase of the transition plan, which involves a completed design and work plan to measure the differences between IFRS and Canadian GAAP, and the impact on the financial statements, disclosures and results of operations.

The Company expects the transition to IFRS to impact financial reporting, accounting policies and business processes. 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. At this time, the impact on the Company's future financial position and results of operations is not reasonably determinable.

Internal Controls Over Financial Reporting

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

- designed the Company's disclosure controls and procedures, or caused them to be designed under their supervision;

- designed the Company's internal control over financial reporting, or caused it to be designed under their supervision; and

- evaluated the effectiveness of the Company's disclosure controls and procedures and the Company's internal control over financial reporting as of June 30, 2009.

During the second quarter of 2009, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting. An evaluation was performed under the supervision and with the participation of the Company's management including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures and the Company's internal control over financial reporting as of June 30, 2009. In addition, independent testing of the effectiveness of the Company's internal control over financial reporting as of December 31, 2008 was performed. The Company's management concluded that the Company's disclosure controls and procedures and the Company's internal control over financial reporting were effective as of June 30, 2009.

Management's Outlook

The first half of 2009, although challenging, certainly displayed the resilience of the Company's business and ability to continue with strong results despite the global economic crisis. The Company's balance sheet remains strong and we continue to evaluate internal growth initiatives and accretive acquisition opportunities.

The market for security papers continues to show strength and our order book for wallpaper base has recovered to healthy levels. Specialty papers from the Landqart mill continue to experience challenges as a result of the global economic slowdown. The Company has responded quickly to these challenges by the implementation of several cost cutting initiatives.

Risks and Uncertainties

A comprehensive discussion of Risk Factors is included in the Company's 2008 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)	Q2 2009	Q1 2009	Q4 2008	Q3 2008
Sales	49,638	46,623	46,331	43,744
Operating income	4,460	3,765	4,399	4,993
EBITDA	5,699	5,032	5,966	6,234
Net income	1,926	3,584	2,778	2,312
Basic EPS	$0.19	$0.35	$0.27	$0.22
Diluted EPS	$0.19	$0.35	$0.27	$0.22
Weighted average shares outstanding Basic (thousands)	10,235	10,235	10,235	10,302
Weighted average shares outstanding Diluted (thousands)	10,235	10,235	10,235	10,471
Average Swiss/Canadian exchange rate(1)	1.0498	1.0845	1.0470	0.9699
Average Euro/Canadian exchange rate (1)	1.5891	1.6226	1.5960	1.5623

(thousands of dollars, except per unit amounts, earnings per share ("EPS"), exchange rates and shares outstanding, unaudited)	Q2 2008	Q1 2008	Q4 2007	Q3 2007
Sales	49,138	49,789	37,537	34,065
Operating income	5,075	5,527	3,380	1,406
EBITDA	6,184	6,643	4,255	2,196
Net income	3,401	4,189	2,279	211
Basic EPS	$0.33	$0.41	$0.22	$0.02
Diluted EPS	$0.33	$0.38	$0.22	$0.02
Weighted average shares outstanding Basic (thousands)	10,248	10,203	10,204	10,049
Weighted average shares outstanding Diluted (thousands)	10,423	11,141	11,141	10,986
Average Swiss/Canadian exchange rate(1)	0.9797	0.9405	0.8563	0.8720
Average Euro/Canadian exchange rate (1)	1.5778	1.5046	1.4213	1.4370

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

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

	As at June 30, 2009	As at December 31, 2008
ASSETS		
Current		
Cash and cash equivalents	$ 24,899	$ 26,187
Trade accounts receivable	28,204	18,108
Other accounts receivable	2,545	3,846
Inventories	30,455	31,968
Prepaid expenses	347	373
	86,450	80,482
Restricted cash	49	49
Deferred expenses	476	–
Property, plant and equipment	44,498	43,536
Employee future benefits *(note 4)*	10,633	11,574
Total assets	$ 142,106	$ 135,641
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	$ 24,149	$ 24,502
Income taxes payable	4,386	5,455
Current portion of long-term debt *(note 5)*	7,003	6,831
	35,538	36,788
Long-term debt *(note 5)*	25,733	23,760
Future income taxes	2,010	2,187
Total liabilities	$ 63,281	$ 62,735
Shareholders' equity *(note 6)*		
Share capital	59,083	59,083
Contributed surplus	2,516	2,107
Retained earnings	17,226	11,716
Total shareholders' equity	78,825	72,906
Total liabilities and shareholders' equity	$ 142,106	$ 135,641

(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, unaudited)

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Sales	$ 49,638	$ 49,138	$ 96,261	$ 98,927
Costs and expenses				
Cost of products sold	(38,618)	(37,125)	(74,681)	(75,325)
Amortization	(1,029)	(733)	(2,096)	(1,473)
Selling, general and administration	(5,321)	(5,829)	(10,849)	(10,775)
Stock-based compensation *(note 7)*	(210)	(376)	(410)	(752)
Operating income	4,460	5,075	8,225	10,602
Other				
Interest, net	(257)	(987)	(449)	(1,138)
Foreign exchange (loss) gain	(766)	(170)	289	773
Net Income before income taxes	3,437	3,918	8,065	10,237
Income tax expense *(note 8)*	(1,511)	(517)	(2,555)	(2,647)
Net income and comprehensive income	$ 1,926	$ 3,401	$ 5,510	$ 7,590
Earnings per share				
Basic	$0.19	$ 0.33	$0.54	$ 0.74
Diluted	$0.19	$ 0.33	$0.54	$ 0.74
Weighted average number of shares outstanding				
Basic	10,233,500	10,248,300	10,233,500	10,226,000
Diluted	10,233,500	10,422,741	10,233,500	10,263,907

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Retained earnings (deficit)				
Balance — beginning of period	$ 15,300	$ 3,967	$ 11,716	$ (222)
Redemption of Convertible Note *(note 5)*	–	(742)	–	(742)
Earnings	1,926	3,401	5,510	7,590
Balance — end of period	$ 17,226	$ 6,626	$ 17,226	$ 6,626

(See accompanying notes)

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

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Cash flows from operating activities				
Net income	$ 1,926	$ 3,401	$ 5,510	$ 7,590
Items not affecting cash:				
Amortization	1,029	733	2,096	1,473
Future income taxes *(note 8)*	(83)	(1,054)	(177)	(563)
Foreign exchange loss (gain) on long term debt	(881)	(898)	(1,947)	3,115
Foreign exchange loss on operating loan	-	-	-	256
Foreign exchange loss (gain) on cash and cash equivalents	369	(75)	605	(1,854)
Stock based compensation	209	376	409	752
	2,569	2,483	6,496	10,769
Non-operating interest penalty *(note 5)*	-	951	-	951
Change in non-cash working capital items				
Accounts receivable	(2,113)	2,676	(8,795)	(3,189)
Inventory	1,423	(679)	1,513	(1,810)
Prepaid expenses	62	87	26	137
Other assets	441	236	941	(1,457)
Accounts payable and other	1,443	1,881	(841)	4,244
	3,825	7,635	(660)	9,645
Cash flows from financing activities				
Shares repurchased	-	-	-	(1)
Redemption of Convertible Note, including penalties *(note 5)*	-	(8,176)	-	(8,176)
Repayment of long-term debt	(1,762)	(1,520)	(1,949)	(1,944)
Proceeds from long-term debt	5,960	2,365	6,041	4,124
Repayment of operating loans	-	-	-	(6,110)
Payment on capital leases	(77)	-	(156)	-
	4,121	(7,331)	3,936	(12,107)
Cash flows from investing activities				
Additions to property, plant and equipment	(1,834)	(4,334)	(3,483)	(6,367)
Deferred expenses	(165)	-	(476)	-
Restricted cash	-	-	-	(3)
	(1,999)	(4,334)	(3,959)	(6,370)
(Decrease) increase in cash position	5,947	(4,030)	(683)	(8,832)
Foreign exchange (loss) gain on cash and cash equivalents	(369)	75	(605)	1,854
Cash and cash equivalents, beginning of period	19,321	42,284	26,187	45,307
Cash and cash equivalents, end of period	$ 24,899	$ 38,329	$ 24,899	$ 38,329

Supplementary cash flow information *(note 11)*

(See accompanying notes)

1. NATURE OF OPERATIONS

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

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, 2008 consolidated financial statements except as disclosed in Note 2.

2. CHANGE IN ACCOUNTING POLICY

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.

3. NEW ACCOUNTING PRONOUNCEMENTS

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

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

4. EMPLOYEE FUTURE BENEFITS

Defined benefit pension expenses of $386 and $785 were recorded for the three and six month periods ended June 30, 2009. Defined benefit pension expenses of $138 and $257 were recorded for the three and six month periods ended June 30, 2008.

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

5. LONG-TERM DEBT AND OPERATING LOANS

Long-term debt

	June 30, 2009	December 31, 2008
Credit agreement with bank maturing 2009 and 2013; interest at 2.65% and 4.5% secured by current assets (EUR 3,619; 2008- EUR 962)	$ 5,899	$ 1,640
Credit agreement with bank maturing 2010, and 2011; interest at 2.75%, 2.3% and 3.8% secured by mortgage (CHF 3,750; 2008 - CHF 3,950)	4,011	4,532
Credit agreement with bank maturing 2012; interest at 4.8% unsecured (CHF 5,495; 2008 - CHF 6,280)	5,878	7,204
Credit agreement with bank maturing 2009, 2011, 2013 and 2018; interest up to 3.1% and 5.9% secured by fixed assets (CHF 15,210; 2008 - CHF 14,244)	16,270	16,340
Capital leases; interest at 4.7% (CHF 5; 2008 - CHF 19)	5	21
Capital leases; interest at 4.0% (EUR 412 and; 2008 - EUR 501)	673	854
	32,736	30,591
Less: Current portion	(7,003)	(6,831)
	$ 25,733	$ 23,760

Operating loans

During 2008 the Company fully repaid and closed its operating loans.

Convertible note

During the three month period ended June 30, 2008 the Company redeemed in full a convertible note in the principal amount of $7,500 with a maturity date of August 2011. The Company had initially recorded a liability portion of $6,900 and an equity portion of $600 in contributed surplus. The liability portion was calculated using present value of future cash outflows using a 10% discount rate.

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

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

6. SHAREHOLDERS' EQUITY

(a) **Authorized:**

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

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

	Number of Shares	Share Capital	Contributed Surplus
Balance, December 31, 2007	10,203,500	$ 58,428	$ 1,508
Stock compensation	—	—	1,388
Share repurchase	(75,000)	(473)	(189)
Shares issued on redemption of Convertible Note *(note 6)*	105,000	1,128	(600)
Balance, December 31, 2008	10,233,500	$ 59,083	$ 2,107
Stock compensation	—	—	409
Balance, June 30, 2009	10,233,500	$ 59,083	$ 2,516

7. STOCK OPTIONS

During 2006 the Company adopted a stock incentive plan. The exercise price of options granted under the Stock Option Plan shall be as determined by the Board of Directors when such options are granted, subject to any limitations imposed by any relevant stock exchange or regulatory authority. The maximum number of options that may be granted must not exceed 10% of the common shares outstanding at the time of the grant.

In June 2009, options were granted for 35,000 shares which vest over two years to an employee and officer of the Company with an exercise price of $8.00. The weighted average fair value 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 are 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

During the quarter ended June 30, 2009 options for 307,500 shares, held by directors and officers of the Company were cancelled.

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

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

	Number of options	Exercise Price
Granted April 5, 2007	320,350	$ 8.00
Granted May 2, 2007	122,325	8.00
Granted November 1, 2007	540,000	8.00
Balance, December 31, 2007	982,675	$ 8.00
Granted January 1, 2008	30,000	$ 8.00
Balance, December 31, 2008	1,012,675	$ 8.00
Cancelled May 25, 2009	(25,000)	$ 8.00
Cancelled June 10, 2009	(282,500)	8.00
Granted June 23, 2009	35,000	8.00
Balance, June 30, 2008	740,175	$ 8.00

As at June 30, 2009, 486,842 stock options were exercisable (December 31, 2008 – 535,117). No stock options were exercised during the three or sixth month period ended June 30, 2009, or during the year ended December 31, 2008. 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 June 30, 2009 is 3.27 years.

8. FUTURE INCOME TAXES

During the quarter ended June 30, 2008 the combined tax rate in Landqart, Switzerland was reduced to 18.9% from 29.0%. As a result a future income tax recovery of $1,054 was recorded during the quarter ended June 30, 2008 relating to the Company's defined benefit pension plan.

9. RELATED PARTY TRANSACTIONS

There were no transactions with related parties during the six month period ended June 30, 2009. In the six month period ended June 30, 2008, the Company has paid or accrued office and administration expenses of $38 to a Company with a common director.

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

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

10. 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 three month period ended June 30, 2009, the Company earned revenue from one customer representing approximately 11% of sales. No single customer accounted for 10% or more of the Company's total sales for the three months ended June 30, 2008. During the six month period ended June 30, 2009, the Company earned revenue from two customers each representing approximately 10% of sales. No single customer accounted for 10% or more of the Company's total sales for the six months ended June 30, 2008.

	Three months ended June 30, 2009			
	Dresden Mill (Germany)	**Landqart Mill** (Switzerland)	**Corporate** (Canada)	**Fortress Paper Consolidated**
Sales	$ 28,777	20,861	—	$ 49,638
Operating earnings (loss)	$ 5,477	28	(1,045)	$ 4,460
Amortization	$ (514)	(515)	—	$ (1,029)
Stock-based compensation[1]	$ —	—	(210)	$ (210)
Capital expenditures	$ 162	1,521	—	$ 1,683
Property, plant and equipment	$ 16,723	27,775	—	$ 44,498
Sales by geographic area	%	%		%
Germany	54.6	19.0		39.7
Switzerland	—	28.1		11.8
Other Western Europe	21.1	36.1		27.4
Eastern Europe	23.3	7.7		16.7
Other	1.0	9.1		4.4
Total	100.0	100.0	—	100.0

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

	Three months ended June 30, 2008			
	Dresden Mill (Germany)	**Landqart Mill** (Switzerland)	**Corporate** (Canada)	**Fortress Paper Consolidated**
Sales	$ 29,139	19,999	—	$ 49,138
Operating earnings (loss)	$ 5,245	822	(992)	$ 5,075
Amortization	$ (359)	(374)	—	$ (733)
Stock-based compensation[2]	$ —	—	(376)	$ (376)
Capital expenditures	$ 2,080	2,107	—	$ 4,187
Property, plant and equipment	$ 12,201	23,519	—	$ 35,720
Sales by geographic area	%	%		%
Germany	49.6	24.0		39.2
Switzerland	—	19.9		8.1
Other Western Europe	26.0	31.7		28.3
Eastern Europe	23.1	12.4		18.7
Other	1.3	12.0		5.7
Total	100.0	100.0	—	100.0

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

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

	Six months ended June 30, 2009			
	Dresden Mill (Germany)	**Landqart Mill** (Switzerland)	**Corporate** (Canada)	**Fortress Paper Consolidated**
Sales	$ 55,039	41,222	—	$ 96,261
Operating earnings (loss)	$ 9,511	868	(2,154)	$ 8,225
Amortization	$ (1,103)	(993)	—	$ (2,096)
Stock-based compensation[1]	$ —	—	(410)	$ (410)
Capital expenditures	$ 1,128	1,930	—	$ 3,058
Property, plant and equipment	$ 16,723	27,775	—	$ 44,498
Sales by geographic area	**%**	**%**		**%**
Germany	43.3	18.3		32.6
Switzerland	0.2	27.8		12.0
Other Western Europe	23.3	37.4		29.3
Eastern Europe	31.6	5.8		20.6
Other	1.6	10.7		5.5
Total	100.0	100.0	—	100.0

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

	Six months ended June 30, 2008			
	Dresden Mill (Germany)	**Landqart Mill** (Switzerland)	**Corporate** (Canada)	**Fortress Paper Consolidated**
Sales	$ 58,203	40,724	—	$ 98,927
Operating earnings (loss)	$ 10,977	1,572	(1,947)	$ 10,602
Amortization	$ (742)	(731)	—	$ (1,473)
Stock-based compensation[2]	$ —	—	(752)	$ (752)
Capital expenditures	$ 2,438	4,129	—	$ 6,567
Property, plant and equipment	$ 12,201	23,519	—	$ 35,720
Sales by geographic area	**%**	**%**		**%**
Germany	51.2	15.4		33.4
Switzerland	—	20.4		12.4
Other Western Europe	24.9	38.5		29.1
Eastern Europe	21.4	13.0		18.6
Other	2.5	12.7		6.5
Total	100.0	100.0	—	100.0

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

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

11. SUPPLEMENTARY CASH FLOW INFORMATION

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Interest paid	$245	$979	$464	$1,366
Income taxes paid	937	51	3,561	100

Non cash items

Non cash property, plant and equipment purchases included in accounts payable decreased by $228 for the three months ended June 30, 2009 and decreased by $146 for the three months ended June 30, 2008.

Non cash property, plant and equipment purchases included in accounts payable decreased by $581 for the six months ended June 30, 2009 and increased by $201 for the six months ended June 30, 2008.