Fortress Paper LTD.
TSX: FTP

Q4 2007

For the period December 31st, 2007

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 has been prepared in accordance with GAAP and should be read in conjunction with the audited financial statements and the notes thereto for the year ended December 31, 2007 (available on SEDAR at www.sedar.com). The MD&A provides a review of the significant developments that have impacted Fortress Paper Ltd.'s (the "Company") performance during the year and quarter ended December 31, 2007 relative to the previous quarter. No prior year comparative financial information has been presented because the transfer of the Mills by Mercer International Inc. to the Company occurred effective August 1, 2006.

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. Fortress Paper Ltd. does not undertake any obligations to release publicly any revisions for updating any voluntary forward-looking statements.

Throughout this discussion, reference is made to EBITDA (defined as operating earnings plus amortization and stock compensation), which Fortress Paper Ltd. considers to be an indicative measure of a company's 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 Canadian generally accepted accounting principles (GAAP). As there is no standardized method of calculating EBITDA, Fortress Paper Ltd.'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 February 29, 2008.

All financial references are in thousands of Canadian dollars unless otherwise noted.

Description of Business

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

The Company was initially established as a wholly owned subsidiary of Mercer International Inc. ("Mercer"). As part of its strategy to focus exclusively on its pulp business, Mercer determined in 2006 to sell certain of its non-core paper assets. In connection with the transaction, on August 1, 2006, Mercer indirectly transferred two paper mills, Dresden Papier in Germany and Landqart in Switzerland, to the Company in consideration for a secured convertible note, in the principal amount of $7,500 and preferred shares with a redemption value of $7,500. On August 1, 2006, certain private equity investors subscribed for $8,000 of Shares of the Company. Upon receipt of the initial subscription proceeds, the Company utilized $7,500 of such proceeds to redeem all of the preferred shares and shares owned by Mercer and reorganized the Board and management of the Company.

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

Revenue & Earnings Comparison

Selected Quarterly Information

($ thousands, except earnings per share ("EPS") amounts which are in $)

	2007 (unaudited)				
	Q4	**Q3**	**Q2**	**Q1**	**YTD**
Sales	37,537	34,065	35,441	38,251	145,294
Operating income	3,380	1,406	3,364	2,448	10,598
EBITDA	4,255	2,196	4,319	2,841	13,611
Net income	2,279	211	1,700	1,094	5,284
Basic EPS	$0.22	$0.02	$0.40	$0.35	$0.76
Diluted EPS	$0.22	$0.02	$0.38	$0.20	$0.76
Weighted average shares outstanding Basic	10,204	10,049	4,275	3,102	6,935
Weighted average shares outstanding Diluted	11,141	10,986	5,212	6,227	7,873
Average Swiss/Canadian exchange rate(1)	0.8563	0.8720	0.8982	0.9501	0.8946
Average Euro/Canadian exchange rate (1)	1.4213	1.4370	1.4801	1.5355	1.4691

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

Results of operations for three months and year ended December 31, 2007

Three Months Ended December 31, 2007

Landqart Overview. The Company's results for the fourth quarter reflect a higher portion of our sales attributed to security papers rather than specialty papers. Security papers traditionally offer higher sales per tonne prices and higher EBITDA margins.

Dresden Overview. During the fourth quarter the Company continued its focus on shifting production to more non-woven wallpaper base which offers higher sales per tonne and higher EBITDA margins.

Sales. Sales for the three months ended December 31, 2007 totaled $37.5 million compared to $34.1 million in the prior quarter. The Landqart Mill and the Dresden Mill contributed $17.1 million ($13.3 million in the prior quarter) and $20.4 million ($20.8 million in the prior quarter) of sales revenue, respectively. Total shipments during the period were 13,247 tonnes, comprised of 4,138 tonnes of security and specialty papers from the Landqart Mill and 9,109 tonnes of wallpaper base from the Dresden Mill. This compared to the prior quarter shipments of 12,798 tonnes, comprised of 3,864 tonnes of security and specialty papers from the Landqart Mill and 8,934 tonnes of wallpaper base from the Dresden Mill. The average sales revenue per tonne at the Landqart Mill and Dresden Mill was $4,126 per tonne and $2,247 per tonne, respectively, during the period. In the previous quarter the average sales revenue per tonne at the Landqart Mill and Dresden Mill was $3,439 per tonne and $2,325 per tonne, respectively, during the period.

Cost of Products Sold. Cost of products sold were $28.1 million or 74.9% of sales for the three months ended December 31, 2007, and reflected a $0.5 million over-funded pension adjustment which decreased cost of products sold by the corresponding amount. In the prior quarter cost of products sold were $28.2 million or 82.7%. The mill operated at full capacity during the fourth quarter. Other than the planned shut down for capital upgrades over a period of approximately three weeks, the Mills operated at full capacity in the previous quarter.

Selling, General and Administrative. Selling, general and administrative expenses were $5.2 million (prior quarter $3.7 million) and were comprised primarily of sales commissions, marketing, corporate and administrative expenses. The increase relative to the prior quarter is primarily due to commissions associated with the customer and product mix.

Stock-based Compensation. Stock-based compensation expense was $0.3 million during the period ($0.1 million in the prior quarter) reflecting a grant of 442,675 options issued to directors and officers of the Company in the second quarter and a grant of 540,000 options issued to directors and officers in November 2007.

EBITDA. As a result of the foregoing factors, EBITDA was $4.3 million for the three months ended December 31, 2007 (prior quarter $2.2 million).

Net earnings to EBITDA reconciliation:

	Three Months Ended December 31, 2007 (unaudited)
Net earnings	$2,279
Income tax	906
Other expense	58
Interest expense	137
Amortization	588
Stock based compensation	287
EBITDA	$4,255

Year Ended December 31, 2007

Landqart and Dresden Overview. Landqart's results for the year reflect a higher portion of our sales attributed to security papers rather than specialty papers. Security papers traditionally offer higher sales per tonne prices and higher EBITDA margins. The Dresden mill continues to focus on shifting production to more non-woven wallpaper base which offers higher sales per tonne and higher EBITDA margins. During the third quarter of the year ended December 31, 2007 the Company completed its scheduled shutdowns to implement capital expenditure upgrades at both mills in order to increase higher margin production capacity. While the results of the upgrades to the mills are positive, the results particularly in the third quarter were negatively impacted.

Sales. Sales for the year ended December 31, 2007 totaled $145.3 million. The Landqart Mill and the Dresden Mill contributed $63.3 million and $82.0 million of sales revenue, respectively. Total shipments during the period were 52,093 tonnes, comprised of 16,268 tonnes of security and specialty papers from the Landqart Mill and 35,825 tonnes of wallpaper base from the Dresden Mill. The average sales revenue per tonne at the Landqart Mill and Dresden Mill was $3,890 per tonne and $2,289 per tonne, respectively, during the period.

Cost of Products Sold. Cost of products sold were $113.4 million or 78.0% of sales for the year ended December 31, 2007, and reflected Fortress' increased production of security papers and non-woven coated wallpaper base as well as a $1.1 million over-funded pension adjustment which decreased cost of products sold by the corresponding amount. Other than for planned shutdowns in the third quarter for capital upgrades the mills operated at full capacity during the period.

Selling, General and Administrative. Selling, general and administrative expenses were $18.3 million and were comprised primarily of sales commissions, marketing, corporate and administrative expenses.

Stock-based Compensation. Stock-based compensation expense was $0.9 million during the period reflecting a grant of 442,675 options issued to directors and officers of the Company in the second quarter and a grant of 540,000 options issued to directors and officers in November 2007.

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

Net earnings to EBITDA reconciliation:

	Year Ended December 31, 2007 (unaudited)
Net income	$5,284
Income tax	3,585
Other income	436
Interest expense	1,293
Amortization	2,105
Stock-based compensation	908
EBITDA	$13,611

Liquidity and Capital Resources

The Company has no exposure to asset backed commercial paper or off balance sheet instruments.

Following the transfer of the Mills by Mercer to the Company, Fortress' principal liquidity requirements were for working capital, debt service and the funding of capital expenditures.

In June, 2007, the Company completed its initial public offering ("IPO") of 5,000,000 Common shares at an offering price of $8.00 per share for total gross proceeds of $40.0 million. Net of issuance costs the Company received $35.2 million. At the same time IPO proceeds were used to repay the CHF 6.4 million Stendal Note (CAD 5.6 million).

In July, 2007, pursuant to an underwriting agreement between the Company and the Underwriters dated June 20, 2007, entered into in connections with the initial public offering of the Company, the Underwriters exercised their option to purchase an additional 750,000 Common shares of the Company issued at a price of $8.00 per shares, bringing the total gross proceeds from the initial public offering of Fortress Paper Ltd. to $46.0 million. The Company received $40.6 million, net of $5.4 million issuance costs.

EBITDA amounted to $4.3 million in the three months ended December 31, 2007, $13.6 million in the year ended December 31, 2007.

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 the Convertible Note 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.

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 in the year ended December 31, 2007 provided cash of $5.7 million. Operating activities generated cash of $3.1 million in the fourth quarter compared to a depletion of cash of $0.7 million in the third quarter. Working capital is subject to cyclical operating needs, the timing of collection of receivables and the payment of payables and expenses.

Financing Activities

Financing activities in the year ended December 31, 2007 provided cash of $44.9 million primarily related to the $40.6 million initial public offering funds received net of issuance costs and a $0.8 million private placement which were partially offset by the net increase in debt and operating loans of $3.5 million.

In the fourth quarter financing activities provided cash of $4.4 million related to the net increase of debt and operating loans in the period. In the prior quarter financing activities provided cash of $11.6 million related to $5.4 million from the exercise of the Underwriters option (see "Liquidity and Capital Resources") net of issue costs and net increase in debt by $6.2 million.

Investing Activities

Investing activities in the year ended December 31, 2007 used cash of $12.6 million related to the purchase of plant and equipment at the Mills of $15.5 million and the net release of restricted cash of $2.9 million. During the same period, the Company received 3,500,000 shares of a private company for licensing of LQard Canadian rights. $Nil value has been recorded for this investment.

In the fourth quarter investing activities, which consisted primarily of additions to plant and equipment consumed $2.8 million compared to $8.8 million in the prior quarter.

Related Party Transactions

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

In the five month period ended December 31, 2006, the Company, in the normal course of business, had paid or accrued office and administration expenses of $39 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.

Changes in Accounting Policies and Estimates

Financial Instruments

Effective January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants' new Handbook Sections 3855 "Financial Instruments — recognition and measurement" and Section 1530 "Comprehensive Income".

Section 3855 prescribes when a financial instrument should be recognized on the balance sheet and at what amount. It also specifies how to present financial instrument gains and losses. Under Section 3855, all financial instruments are classified into one of these five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured in the Consolidated Balance Sheet at fair value on initial recognition. Subsequent measurement depends on the initial classification of the instrument. Loans and receivables, held-to-maturity investments and other financial liabilities are measured at amortized cost. All derivative instruments, including embedded derivatives, are recorded in the Consolidated Balance Sheet at fair value unless they qualify for the normal sales and purchases exemption. Changes in the fair value of derivatives that are not exempt are recorded in income.

Section 1530 introduces new requirements for situations when certain gains and losses ("other comprehensive income") must be temporarily presented outside of net income in a new Statement of Comprehensive Income. Comprehensive income (loss) is the change in the Company's net assets that results from transactions, events and circumstances from sources other than the Company's shareholders and includes items that would not normally be included in net earnings such as unrealized gains or losses on available for sale investments. Other comprehensive income includes the holding gains and losses from available for sale securities which are not included in net income (loss) until realized.

The adoption of the new recommendations did not materially impact the Company's financial statements.

New Accounting Pronouncements

The CICA has 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, 2008. The Company will adopt the requirements commencing in the interim period ended March 31, 2008 and is considering the impact this will have on the Company's financial statements.

Section 1535 – Capital Disclosures

This Section establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard the Company will be required to disclose the following, based on the information provided internally to the entity's key management personnel:

(i) qualitative information about its objectives, policies and processes for managing capital,
(ii) summary quantitative data about what it manages as capital.
(iii) whether during the period it complied with any externally imposed capital requirements to which it is subject.
(iv) when the company has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

Section 3031 - Inventories

This Section prescribes the accounting treatment for inventories and provides guidance on the determination of costs and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Section 3862 – Financial Instruments – Disclosures

This Section requires entities to provide disclosure of quantitative and qualitative information in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and management’s objectives, policies and procedures for managing such risks. Entities will be required to disclose the measurement basis or bases used, and the criteria used to determine classification for different types of instruments.

The Section requires specific disclosures to be made, including the criteria for:
(i) designating financial assets and liabilities as held for trading;
(ii) designating financial assets as available-for-sale; and
(iii) determining when impairment is recorded against the related financial asset or when an allowance account is used.

Capital Structure

	Number of Shares	Share Capital	Contributed Surplus
Private placements	2,250,000	$ 9,000	$ —
Convertible debt	—	—	600
Stock compensation	750,000	3,000	—
Performance based compensation	—	—	5,000
Balance, December 31, 2006	3,000,000	$ 12,000	$ 5,600
Private placements	203,500	$ 814	$ —
Performance based compensation	1,250,000	5,000	(5,000)
Initial public offering	5,750,000	46,000	—
Share issue costs	—	(5,386)	—
Stock compensation	—	—	908
Balance, December 31, 2007	10,203,500	$ 58,428	$ 1,508

Number of Common shares outstanding at December 31, 2007 and February 29, 2008 was 10,203,500.
Number of options outstanding at December 31, 2007 and February 29, 2008 was 982,675 and 1,012,675 respectively.

Share capital reorganization

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

Subsequent Events

Options granted

On January 1, 2008, 30,000 options were granted to an employee of the Company.

License agreement

On January 31, 2008, the Company has licensed the exclusive rights to use and exploit identification card technology in the United States and Mexico to iDcentrix, an arm's length party.

Critical Accounting Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in Canada requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates are used for, but not limited to, the accounting for doubtful accounts, depreciation and amortization, asset impairments, 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.

Evaluation of Disclosure Controls

Management has evaluated the effectiveness of the Company's controls as of December 31, 2007. Based on such evaluation they have concluded that, at such time, the Company's disclosure controls were effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed in the Company's periodic filings. It should be noted that any system of controls is based in part upon certain assumptions designed to obtain reasonable assurance as to effectiveness, and there can be no assurance that any design will succeed in achieving its stated objectives.

Management is also responsible for the design of the Company's internal control over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. It should be noted that a control system, no matter how well conceived or operated, can only provide reasonable assurance, not absolute assurance, that the objectives of the control system are met.

Risks and Uncertainties

A comprehensive discussion of Risk Factors was included in the Company's prospectus filing on June 20, 2007 (available on SEDAR at www.sedar.com).

Financial Instruments

Fair values

The fair value of cash and cash equivalents, restricted cash, accounts receivable, operating loans, accounts payable and accrued liabilities, and deposits approximate their carrying values given the short term maturity of these instruments. The estimated fair value of the bank debt incurred is estimated by reference to current market rates for debt securities with similar term and characteristics and is not materially different from the book value.

Credit risk

The financial instruments that potentially expose the Company to a concentration of credit risk are cash and short term investments and accounts receivables. The Company limits its exposure to credit loss by depositing cash with qualified financial institutions. Management regularly monitors the credit worthiness of its debtors and believes that it has adequately provided any exposure to potential credit loss.

Currency risk

A significant portion of the Company's earnings is generated from sales denominated in Euro and Swiss francs. The Company does not use forward exchange contracts to reduce its exposure to exchange rate movements, however, the Company has a significant portion of its long-term debt denominated in both Euro and Swiss francs.

Management Outlook

Fortress Paper successfully achieved several significant milestones in 2007. Some of the highlights included new additions to the management team, completion of a public listing, and the successfully implementation of capacity increases at both mills. With new capacity available and strong industry fundamentals the company is very well positioned going into 2008. The market for security papers remains strong with the driving forces continuing to be innovation to stay ahead of counterfeiters, quality of the end products, and the confidence in and reputation of suppliers. The wallpaper base market's trend of displacing traditional paper-based products with the improved non-woven wallpaper bases continues to be a major factor in the industry with positive implications for Fortress Paper Ltd. The company has a very strong balance sheet and continues to selectively evaluate both organic opportunities to further increase capacity and external acquisitions to take advantage of strong industry fundamentals for our portfolio of products.

Earning Sensitivity

Based on production and sales for the year ended December 31, 2007, changes in pulp prices and exchange rates affect EBITDA as follows:

Pulp price sensitivity – 1% price increase	$270 negative impact
Canadian dollar sensitivity – 1% strengthening against the Euro and Swiss Franc	$153 negative impact

FORTRESS PAPER LTD.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2007

AND

FIVE MONTH PERIOD ENDED DECEMBER 31, 2006

(Canadian dollars, amounts in thousands)

PRICEWATERHOUSECOOPERS

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Auditors' report

To the Shareholders of
Fortress Paper Ltd.

We have audited the consolidated balance sheets of Fortress Paper Ltd. as at December 31, 2007 and December 31, 2006, and the consolidated statements of operations and comprehensive income (loss), deficit and accumulated other comprehensive earnings, and cash flows for the year and the five month period then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and December 31, 2006, and the results of its operations and its cash flows for the year and the five month period then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Vancouver, BC
March 3, 2008

FORTRESS PAPER LTD.

CONSOLIDATED BALANCE SHEETS

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

	2007	2006
ASSETS		
Current		
Cash and cash equivalents	$ 45,307	$ 7,320
Trade accounts receivable	11,778	13,620
Other accounts receivable	2,899	1,729
Inventories *(note 5)*	23,808	18,721
Prepaid expenses	420	249
	84,212	41,639
Restricted cash *(note 10)*	44	2,972
Property, plant and equipment *(note 7)*	30,626	16,426
Other assets *(note 8)*	8,303	8,236
Total assets	$ 123,185	$ 69,273
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Operating loans *(note 9)*	$ 5,854	$ 4,253
Accounts payable and accrued liabilities	20,319	18,777
Income taxes payable	3,241	584
Other current liabilities *(note 10)*	3,037	5,494
Current portion of long-term debt *(note 9)*	4,813	3,595
	37,264	32,703
Long-term debt *(note 9)*	23,799	22,102
Future income taxes *(note 17)*	2,408	2,374
Total liabilities	$ 63,471	$ 57,179
Shareholders' equity *(note 11)*		
Share capital	58,428	12,000
Contributed surplus	1,508	5,600
Deficit	(222)	(5,506)
Total shareholders' equity	59,714	12,094
Total liabilities and shareholders' equity	$ 123,185	$ 69,273

Subsequent events *(note 21)*
Commitments *(note 14)*

Approved by the Board of Directors:

"Chadwick Wasilenkoff"
Director

"Richard O'C. Whittall"
Director

FORTRESS PAPER LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

Year ending December 31, 2007 and five month period ended December 31, 2006
(Canadian dollars, amounts in thousands)

	2007	2006
Sales	$ 145,294	$ 53,254
Costs and expenses		
Cost of products sold	(113,409)	(43,997)
Amortization	(2,105)	(855)
Selling, general and administration	(18,274)	(4,244)
Stock-based compensation *(note 11 and 12)*	(908)	(7,999)
Operating income (loss)	10,598	(3,841)
Other		
Interest, net *(note 16)*	(1,293)	(769)
Other income (expenses), net	2	1
Foreign exchange (loss) gain	(438)	138
Net Income (loss) before income taxes	8,869	(4,471)
Income tax expense *(note 17)*	(3,585)	(1,035)
Net income (loss) and comprehensive income (loss)	$ 5,284	$ (5,506)
Earning (loss) per share		
Basic and diluted	$ 0.76	$ (2.76)
Weighted average number of shares outstanding		
Basic and diluted	6,935,337	1,991,861

FORTRESS PAPER LTD.

CONSOLIDATED STATEMENTS OF DEFICIT AND ACCUMULATED OTHER COMPREHENSIVE EARNINGS

Year ending December 31, 2007 and five month period ended December 31, 2006
(Canadian dollars, amounts in thousands)

	2007	2006
Deficit		
Balance — beginning of period	$ (5,506)	$ —
Earnings (loss)	5,284	(5,506)
Balance — end of period	$ (222)	$ (5,506)
Accumulated other comprehensive earnings		
Balance — beginning and end of period	$ —	$ —

FORTRESS PAPER LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ending December 31, 2007 and five month period ended December 31, 2006
(Canadian dollars, amounts in thousands)

	2007	2006
Cash flows from operating activities		
Net income (loss)	$ 5,284	$ (5,506)
Items not affecting cash:		
Amortization	2,105	855
Future income taxes	34	607
Foreign exchange (gain) loss on long term debt	(1,683)	801
Foreign exchange (gain) loss on operating loan	(371)	206
Stock based compensation	908	7,999
	6,277	4,962
Change in non-cash working capital items		
Accounts receivable	672	(4,395)
Inventory	(5,087)	(39)
Prepaids	(171)	(249)
Other assets	(67)	(901)
Accounts payable and other	4,088	9,753
	5,712	9,131
Cash flows from financing activities		
Issuance of common shares *(note 11)*	41,428	9,000
Repayment of long-term debt	(7,926)	(461)
Proceeds from long-term debt	12,389	2,038
Proceeds from (repayment of) operating loans	1,972	(1,807)
Repayment of note payable *(note 10)*	(2,999)	—
Payment on capital leases	(1,248)	—
Redemption of preferred shares	—	(7,500)
	43,616	1,270
Cash flows from investing activities		
Additions to property, plant and equipment	(14.269)	(5,050)
Cash acquired on acquisition *(note 4)*	—	4,941
Restricted cash *(note 10)*	2,928	(2,972)
	(11,341)	(3,081)
Increase in cash position	37,987	7,320
Cash and cash equivalents, beginning of period	7,320	—
Cash and cash equivalents, end of period	$ 45,307	$ 7,320

Supplemental cash flow *(note 19)*

(See accompanying notes)

1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The Company was initially established as a wholly owned subsidiary of Mercer International Inc. ("Mercer"). As part of its strategy to focus exclusively on its pulp business, Mercer determined in 2006 to sell certain of its non-core paper assets. In connection with the transaction, on August 1, 2006, Mercer indirectly transferred two paper mills, Dresden Papier in Germany and Landqart in Switzerland, to the Company in consideration for a secured convertible note, in the principal amount of $7,500 and preferred shares with a redemption value of $7,500. On August 1, 2006, certain private equity investors subscribed for $8,000 of Shares of the Company. Upon receipt of the initial subscription proceeds, the Company utilized $7,500 of such proceeds to redeem all of the preferred shares and shares owned by Mercer and reorganized the Board and management of the Company.

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

Basis of Presentation

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

All significant intercompany transactions and balances have been eliminated.

Revenue and Related Cost Recognition

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

Estimates

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

Foreign Currency Translation

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

Cash and Cash Equivalents

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

Inventories

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

Property, Plant and Equipment

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

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

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

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

Impairment of long-lived assets

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

Employee future benefits

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

The Company has adopted the following policies:

- The measurement date used for accounting purposes is December 31;
- The cost of pensions earned by employees is actuarially determined using the projected benefit method pro-rated on service and management's estimate of expected plan investment performance, salary escalation and retirement ages of employees;
- For the purpose of calculating the expected return on plan assets, those assets are valued at fair value;
- The excess of the net actuarial gain (loss) over 10% of the greater of the benefit obligations and the fair value of plan assets is amortized over the average remaining service period of the active employees which is 8.9 years (2006 – 9.0 years)

Income taxes

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

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

Earnings (loss) per share

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

In the periods ended December 31, 2007 and 2006, the stock options, performance options and share awards, as disclosed in note 12, were not included in the computation of loss per share as their inclusion would be anti-dilutive.

Stock-based compensation

The Company has a stock option plan as described in note 12. The Company uses the Black-Scholes Option Pricing Model to estimate the fair value of each stock option at the date of the initial public offering ("IPO date") or grant date for options granted post IPO date. The value of stock options granted to directors and officers is recorded as stock-based compensation and credited to contributed surplus over the relevant vesting period. Any consideration received on the exercise of stock options is credited to share capital and the appropriate original fair value is reallocated from contributed surplus to share capital.

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

2. CHANGES IN ACCOUNTING POLICIES AND ESTIMATES

Financial Instruments

Effective January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants' new Handbook Sections 3855 "Financial Instruments — recognition and measurement" and Section 1530 "Comprehensive Income".

Section 3855 prescribes when a financial instrument should be recognized on the balance sheet and at what amount. It also specifies how to present financial instrument gains and losses. Under Section 3855, all financial instruments are classified into one of these five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured in the Consolidated Balance Sheet at fair value on initial recognition. Subsequent measurement depends on the initial classification of the instrument. Loans and receivables, held-to-maturity investments and other financial liabilities are measured at amortized cost. All derivative instruments, including embedded derivatives, are recorded in the Consolidated Balance Sheet at fair value unless they qualify for the normal sales and purchases exemption. Changes in the fair value of derivatives that are not exempt are recorded in income.

Section 1530 introduces new requirements for situations when certain gains and losses ("other comprehensive income") must be temporarily presented outside of net income in a new Statement of Comprehensive Income. Comprehensive income (loss) is the change in the Company's net assets that results from transactions, events and circumstances from sources other than the Company's shareholders and includes items that would not normally be included in net earnings such as unrealized gains or losses on available for sale investments. Other comprehensive income includes the holding gains and losses from available for sale securities which are not included in net income (loss) until realized.

The adoption of the new recommendations did not materially impact the Company's financial statements.

3. NEW ACCOUNTING PRONOUNCEMENTS

The CICA has 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, 2008. The Company will adopt the requirements commencing in the interim period ended March 31, 2008 and is considering the impact this will have on the Company's financial statements.

Section 1535 – Capital Disclosures

This Section establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard the Company will be required to disclose the following, based on the information provided internally to the entity's key management personnel:

(i) qualitative information about its objectives, policies and processes for managing capital,
(ii) summary quantitative data about what it manages as capital.
(iii) whether during the period it complied with any externally imposed capital requirements to which it is subject.
(iv) when the company has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

Section 3031 - Inventories

This Section prescribes the accounting treatment for inventories and provides guidance on the determination of costs and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Section 3862 – Financial Instruments – Disclosures

This Section requires entities to provide disclosure of quantitative and qualitative information in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and management's objectives, policies and procedures for managing such risks. Entities will be required to disclose the measurement basis or bases used, and the criteria used to determine classification for different types of instruments.

The Section requires specific disclosures to be made, including the criteria for:
(i) designating financial assets and liabilities as held for trading;
(ii) designating financial assets as available-for-sale; and
(iii) determining when impairment is recorded against the related financial asset or when an allowance account is used.

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

4. ACQUISITION OF MILLS

The Company was initially established as a wholly owned subsidiary of Mercer International Inc. As part of its strategy to focus exclusively on its pulp business, Mercer determined in 2006 to sell certain of its non-core paper assets. In connection with the transaction on August 1, 2006, Mercer indirectly transferred two mills, Dresden Papier in Germany and Landqart in Switzerland, to the Company in consideration for a secured convertible note, in the principal amount of $7,500, and preferred shares with a redemption value of $7,500.

The acquisition has been accounted for using the purchase method, in which the purchase consideration was allocated to the estimated fair values of assets and liabilities on the date of acquisition. The allocation of the purchase cost of the acquisition is as follows:

Net Assets acquired at fair values:

Cash	$ 4,941
Accounts receivable and other	11,103
Inventories	18,682
Property, plant and equipment	12,239
Employee future benefit plan	7,185
	54,150
Liabilities assumed:	
Current liabilities	21,278
Future income taxes	1,767
Long term debt	16,055
	39,100
Net assets acquired:	$ 15,050
Consideration paid:	
Cash paid on closing	$ 7,500
Convertible debt	7,500
Closing fees	50
	$ 15,050

5. INVENTORIES

	2007	2006
Raw materials	$ 13,000	$ 7,447
Work in progress	952	1,328
Finished goods	9,856	9,946
	$ 23,808	$ 18,721

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

6. INVESTMENTS

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

7. PROPERTY, PLANT AND EQUIPMENT

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

	2006		
	Cost	Accumulated Amortization	Net Book Value
Land and building	$ 5,789	$ 78	$ 5,711
Production and other equipment	8,940	777	8,163
Construction-in-progress	2,552	—	2,552
	$ 17,281	$ 855	$ 16,426

The net book value and accumulated amortization of capital leases included in production and other equipment was $1,402 and $287 respectively at December 31, 2007 and $593 and $26 respectively at December 31, 2006.

8. OTHER ASSETS

	2007	2006
Employee future benefits *(note 15)*	$ 8,303	$ 7,953
Deferred share issuance costs	—	283
	$ 8,303	$ 8,236

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

9. LONG-TERM DEBT AND OPERATING LOANS

Long-term debt

	2007	2006
Convertible debt due 2011; interest at prime +2% (a)	$ 7,500	$ 7,500
Credit agreement with bank maturing 2009 and 2013; interest at 2.65% secured by current assets (EUR 1,346 and 1,731)	1,943	2,663
Credit agreement with bank maturing 2008, 2009, and 2011; interest at 5.0%, 3.8% and 4.0% secured by mortgage (CHF 4,350 and 4,750)	3,793	4,538
Credit agreement with bank maturing 2009 and 2012; interest at 4.8% and Libor + 2.0% unsecured (CHF 7,850 and 1,632)	6,845	1,559
Credit agreement with bank maturing 2011, 2017 and 2018; interest up to Libor + 2%, 5.8%, and 4.8% secured by fixed assets (CHF 8,566 and 2,372)	7,470	2,265
Note payable to Stendal Pulp maturing 2011; interest at Euribor +3.0% unsecured (CHF 6,400)	—	6,115
Capital leases; interest at 4.7% (CHF 629 and 1,735)	548	1,657
Capital leases; interest at 4.2% (EUR 678 and nil)	978	—
	29,077	26,297
Less: Convertible debt allocated to contributed surplus, net of accretion (a)	(465)	(600)
Less: Current portion	(4,813)	(3,595)
	$ 23,799	$ 22,102

Principal repayments as at December 31, 2007 are required as follows:

	Long term debt	Capital lease	Total
2008	$ 4,026	$ 787	$ 4,813
2009	3,146	271	3,417
2010	3,007	255	3,262
2011	11,815	213	12,028
2012	2,344	—	2,344
Thereafter	3,213	—	3,213
	$ 27,551	$ 1,526	$ 29,077

(a) The Convertible Note is a senior secured convertible note of the Company in the principal amount of $7,500 that matures in August, 2011. The Convertible Note bears interest at an annual rate equal to the prime rate of a national Canadian bank, plus 2%. The Convertible Note is secured by a first security lien upon all or substantially all of the Company's assets.

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

Commencing August 1, 2007, any holder of the Convertible Note (a "Holder") may, at its option, convert the Convertible Note into Shares at any time until the close of business on the last business day prior to maturity. The conversion price shall be at the IPO offering price of $8.00 per share. Notwithstanding the foregoing, the maximum number of Shares issuable to Mercer upon a conversion shall be the number that results in Mercer holding, as close as possible without exceeding, 49.9% of the issued and outstanding Shares as of the date of the applicable conversion.

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

The Company may redeem the Convertible Note on or after August 1, 2009, in whole or in part, at 100% of the principal amount to be redeemed together with interest accrued thereon up to but not including the redemption date.

The Convertible Note also contains positive and negative covenants of the Company customary for secured financings of this nature, including limitations in respect of the granting of security, dispositions of material assets, ceasing to carry on business, consolidation, amalgamation or mergers and the incurrence of indebtedness. In addition, the Company has covenanted to permit Mercer to appoint up to one third of the directors of the Company so long as there remains any outstanding obligation under the Convertible Note.

Operating loans

At December 31, 2007, the Company has approximately $6,659 in operating lines of credit available, of which $5,854 was drawn down. The loans are secured by inventory and accounts receivable. Interest is payable at rates from 5.25% to 6.0%.

At December 31, 2006, the Company had approximately $7,188 in operating lines of credit available secured by inventory and accounts receivable, of which $4,253 was drawn down. Interest is payable at rates from 5.25% to 5.5%.

10. OTHER CURRENT LIABILITIES

	2007	2006
Promissory note to Mercer (EUR 1,950)	$ —	$ 2,999
Other	3,037	2,495
	$ 3,037	$ 5,494

The promissory note bearing interest at 4% was due and repaid January 28, 2007. In the prior year restricted cash of EUR 1,950 was put aside to offset the note. The restricted cash of $44 at December 31, 2007 represents cash for security.

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

11. 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
Private placements	2,250,000	$ 9,000	$ —
Convertible debt	—	—	600
Stock compensation	750,000	3,000	—
Performance based compensation	—	—	5,000
Balance, December 31, 2006	3,000,000	$ 12,000	$ 5,600
Private placements	203,500	$ 814	$ —
Performance based compensation	1,250,000	5,000	(5,000)
Initial public offering	5,750,000	46,000	—
Share issue costs	—	(5,386)	—
Stock compensation	—	—	908
Balance, December 31, 2007	10,203,500	$ 58,428	$ 1,508

Share capital reorganization

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

Private Placements

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

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

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

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

On November 20, 2006 the Company raised $1,000 by the issuance of 250,000 shares.

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

On August 1, 2006 the Company completed its initial private placement of $8,000 by the issuance of 2,000,000 shares.

12. STOCK OPTIONS

Performance options and share awards

In the 5 month period ended December 31, 2006, the Company recognized stock based compensation of $7,999 for the grant or contingent grant of 1,000,000 options and 1,000,000 restricted shares. Stock compensation was determined at $4.00 per option and restricted share, equivalent to the private placement share price, less the exercise price. On August 1, 2006 the Company granted a total of 1,000,000 stock options with an exercise price of $0.002 per option to a director of the Company. Upon the close of the initial private placement 750,000 options became vested and were exercised for $1.50. The remaining 250,000 options vested and were exercised on April 25, 2007 the date that the Company entered into a licensing agreement, on terms approved by the Company, with an entity which is at arm's length to both the Company and Landqart, for the licensing of the LQard security card technology.

Stock options

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

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

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

The estimated fair value for the 982,675 options granted during the year was $3,034. Prorating the total amount based on the vesting schedule $908 has been expensed as stock-based compensation in the statement of operations with a corresponding amount recorded as contributed surplus in shareholders' equity.

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

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

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

Stock option transactions and the number of stock options outstanding are summarised as follows for the year ended December 31, 2007:

	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
As at December 31, 2007	982,675	$ 8.00

As at December 31, 2007, 147,558 stock options were exercisable. No stock options were exercised in the year ended December 31, 2007.

13. RELATED PARTY TRANSACTIONS

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

In the five month period ended December 31, 2006, the Company, in the normal course of business, had paid or accrued office and administration expenses of $39 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.

14. COMMITMENTS

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

	2007
2008	$ 176
2009	157
2010	150
2011	91
2012	60
Thereafter	48
	$ 682

A purchase obligation of $341 is due in 2008.

In previous years, the Dresden Papier mill had received state and federal grants totaling EUR 5,963. As of December 31, 2007 the Company has accrued EUR 404 as a repayment obligation under the terms of the grants. There are no additional repayment obligations as of December 31, 2007.

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

15. EMPLOYEE FUTURE BENEFITS

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

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

	2007	2006
Accrued benefit obligation		
Beginning of period	$ 49,664	$ 46,542
Service cost	1,190	476
Interest cost on accrued obligation	1,375	506
Benefit payments	(302)	(997)
Contributions by plan participants	930	863
Actuarial (gain) loss	(1,763)	345
Foreign exchange	(4,371)	1,929
End of period	$ 46,723	$ 49,664
Plan assets		
Fair value, beginning of period	$ 57,015	$ 53,727
Actual return on plan assets	2,501	857
Employer contributions	928	352
Employee contributions	930	863
Benefit payments	(302)	(998)
Foreign exchange	(5,080)	2,214
End of period	$ 55,992	$ 57,015
Funded status — plan surplus	$ 9,271	$ 7,351
Unamortized net actuarial (gain) loss	(968)	602
Accrued benefit asset	$ 8,303	$ 7,953

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

Expense		
Current service cost	$ 1,190	$ 476
Interest cost	1,375	507
Actual return on plan assets	(2,501)	(857)
Actual actuarial (gain) loss on benefit obligations	(1,763)	345
Expenses before adjustments	(1,699)	471
Difference between expected return and actual return on plan assets	(207)	(231)
Difference between net actuarial (gain) loss recognized and actual (gain) loss on benefit obligations	1,763	(345)
Net expense	$ (143)	$ (105)
Significant actuarial assumptions used are as follows	%	%
Discount rate to determine benefit obligations at end of year	3.3	2.9
Discount rate to determine benefit expense (income) for the year	2.9	2.7
Expected rate of return on plan assets	4.0	5.0
Rate of increase in future compensation	1.5	1.5
Plan assets at fair value at the end of the year	%	%
Liquid assets	4.0	4.0
Bonds	55.0	52.0
Equity — World	22.0	25.0
Real estate	19.0	19.0
	100.0	100.0

16. INTEREST, NET

	2007	2006
Interest expense	$ (2,146)	$ (785)
Interest expense on capital lease	(61)	—
Interest income	914	16
	$ (1,293)	$ (769)

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

17. INCOME TAXES

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

	2007	2006
Future income tax assets (liabilities)		
Pension benefit	$(2,408)	$ (2,307)
Non-capital loss carryforward	3,788	5,486
Property, plant and equipment	4,098	4,747
Share issue costs	1,336	—
Investments	2,317	—
Other	(157)	(67)
	8,974	7,859
Valuation allowance	(11,382)	(10,233)
Net future income tax liability	$(2,408)	$ (2,374)

Non-capital loss carryforward consist of approximately $9,190 from our Landqart operations which expire beginning in 2008 through 2011 and $2,105 from Corporate which expire beginning in 2026 through 2027.

The components of income tax expense are as follows:

	2007	2006
Current	$ (3,446)	$ (495)
Future	(139)	(540)
	$ (3,585)	$ (1,035)

The reconciliation of income taxes calculated at the statutory rate of 34.12% to the actual income tax provision is as follows:

	2007	2006
Net income (loss) before income taxes	$ 8,869	$ (4,471)
Income tax (recovery) at statutory rates	3,026	(1,526)
Stock compensation and other non deductible expenses	214	2,823
Rate differentials between foreign jurisdictions, capital gains and future tax rates	535	(13)
Share issue costs	(1,838)	—
Tax loss carryforward expired (used)	499	(317)
Other	—	68
Change in valuation allowance	1,149	—
Income tax expense	$ 3,585	$ 1,035

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

18. SEGMENTED INFORMATION

The segmentation of the Company's manufacturing operations by mill is based on a number of factors, including production, production processes, and economic characteristics. The accounting policies for each mill are the same as those described in note 1. Landqart produces specialty and security papers while Dresden Papier produces non-woven wallpaper base products. During the year ended December 31, 2007, the Company earned revenue from one customer of $15,910 representing 10.9% of sales. During the previous period ended December 31, 2006 no single customer accounted for 10% or more of the Company's total sales.

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

2006		Dresden Papier (Germany)	Landqart (Switzerland)	Corporate (Canada)		Fortress Paper Consolidated
Sales	$	29,732	23,522	—	$	53,254
Operating earnings (loss)	$	1,376	3,008	(8,225)	$	(3,841)
Amortization	$	411	444	—	$	855
Stock-based compensation	$	—	—	7,999	$	7,999
Capital expenditures	$	1,891	3,151	—	$	5,042
Property, plant and equipment	$	8,922	7,504	—	$	16,426
Sales by geographic area		%	%			%
Germany		51.4	10.6			33.7
Switzerland		—	31.9			13.8
Other Western Europe		22.8	39.5			30.1
Eastern Europe		24.3	7.2			16.9
Other		1.5	10.7			5.5
Total		100.0	100.0	—		100.0

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

19. SUPPLEMENTAL CASH FLOW

Supplemental information	**2007**	**2006**
Interest paid	$ 2,060	$ 634
Income taxes paid	$ 539	$ 14

Non cash items

During the year ended December 31, 2007, the Company received 3,500,000 shares of a private company for licensing of LQard Canadian rights. $Nil value has been recorded for this investment.

Non cash property, plant and equipment purchases included in accounts payable were $788 at December 31, 2007 and $nil at December 31, 2006.

During the 5 month period ended December 31, 2006, the Company issued $7,500 preferred shares and $7,500 in convertible debt in exchange for the Landqart and Dresden Papier mills. *(note 4)*

20. FINANCIAL INSTRUMENTS

Fair values

The fair value of cash and cash equivalents, restricted cash, accounts receivable, operating loans, accounts payable and accrued liabilities, and deposits approximate their carrying values given the short term maturity of these instruments. The estimated fair value of the bank debt incurred is estimated by reference to current market rates for debt securities with similar term and characteristics and is not materially different from the book value.

Credit risk

The financial instruments that potentially expose the Company to a concentration of credit risk are cash and short term investments and accounts receivables. The Company limits its exposure to credit loss by depositing cash with qualified financial institutions. Management regularly monitors the credit worthiness of its debtors and believes that it has adequately provided any exposure to potential credit loss.

Currency risk

A significant portion of the Company's earnings is generated from sales denominated in Euro and Swiss francs. The Company does not use forward exchange contracts to reduce its exposure to exchange rate movements, however, the Company has a significant portion of its long-term debt denominated in both Euro and Swiss francs.

21. SUBSEQUENT EVENTS

Options granted

On January 1, 2008, 30,000 options were granted to an employee of the Company.

License agreement

On January 31, 2008, the Company has licensed the exclusive rights to use and exploit identification card technology in the United States and Mexico to iDcentrix.