FORTRESS PAPER LTD.

Q4 2009

FOR THE THREE MONTHS AND YEAR ENDED

DECEMBER 31, 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 audited consolidated financial statements and the notes thereto for the year ended December 31, 2009 (available on SEDAR at www.sedar.com). The MD&A provides a review of the significant developments that have impacted the Company's performance during the quarter ended December 31, 2009 relative to the previous quarter and prior year comparative quarter, and the year ended December 31, 2009 relative to the year ended December 31, 2008.

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 February 12, 2010.

All financial references are in Canadian dollars unless otherwise noted.

Highlights

Fortress reported net income of $3.7 million for the fourth quarter of 2009 on sales of $51.0 million or diluted earnings per share of $0.35. For the fourth quarter of 2008 the Company reported net income of $2.8 million on sales of $46.3 million or basic and diluted earnings per share of $0.27. In the third quarter of 2009 the Company reported net income of $3.5 million on sales of $51.0 million or basic and diluted earnings per share of $0.34.

Adjusted net income for the fourth quarter of 2009 was $0.47 per share. Adjusted net income for the previous year comparative period and third quarter of 2009 was $0.28 per share and $0.38 per share, respectively.

EBITDA was $7.9 million or 15.4% of sales for the three months ended December 31, 2009. For the three months ended December 31, 2008 EBITDA was $6.0 million or 13.2% of sales. EBITDA for the third quarter of 2009 was $7.0 million or 13.7% of sales.

In the fourth quarter of 2009 both mills experienced strong sales and earnings throughout the quarter. The increase in EBITDA relative to the prior year comparative period was partially due to the global financial and economic crisis which impacted sales late in 2008.

For the year ended December 31, 2009, Fortress Paper recorded net income of $12.7 million or $1.23 per share (diluted) on sales of $198.3 million. For the year ended December 31, 2008, the Company recorded net income of $12.7 million or $1.24 per share (diluted) on sales of $189.0 million.

Adjusted net income for the year ended December 31, 2009 was $13.8 million or $1.34 per share (diluted). Adjusted net income for the previous year comparative period was $13.3 million or $1.30 per share (diluted).

EBITDA was $25.6 million for the year ended December 31, 2009 compared to $25.0 for the year ended December 31, 2008.

EBITDA relative to the prior year was slightly improved. Due to the global financial and economic crisis Fortress experienced a slow start to the year; however, this was more than compensated by a very strong second half. Order logs for both mills continue to show strength.

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.

Fourth Quarter 2009 Earnings Review

Three Months Ended December 31

Selected Financial Information and Statistics

(thousands of dollars, except shipments, unaudited)	**Q4 2009**	**Q3 2009**	**Q4 2008**
Sales	51,049	51,000	46,331
EBITDA[1]	7,885	6,967	5,966
Operating income	6,292	5,198	4,399
Net income	3,720	3,467	2,778
Shipments (tonnes)	15,291	14,304	11,249

[1]See net income to EBITDA reconciliation.

Analysis of Specific Items Affecting Comparability of Net Income

(thousands of dollars, except per share figures, unaudited)	**Q4 2009**	**Q3 2009**	**Q4 2008**
Net income as reported	3,720	3,467	2,778
Foreign exchange loss (gain)	1,073	365	113
Adjusted net income	4,793	3,832	2,891
Net income per share (EPS), as reported	0.35	0.34	0.27
Impact of above item per share	0.12	0.04	0.01
Adjusted net income per share	0.47	0.38	0.28

Overview

At the Landqart mill the market for security papers continues to show strength. The Landqart mill results for the quarter reflect solid banknote paper sales, realization of cost cutting initiatives and a $0.5 million pension adjustment which decreased cost of products sold by the corresponding amount.

At the Dresden mill, the wallpaper base market experienced strong orders throughout the fourth quarter. Profitability remains strong and the order book has maintained its highest levels of the year.

Sales. Sales for the three months ended December 31, 2009 were similar to the third quarter of 2009 primarily due to the continued strength in the markets throughout the fourth quarter. Sales for the three months ended December 31, 2009 were significantly higher when compared to the prior year comparative quarter due to much lower tonnage sold in the prior year as a direct consequence of the global economic slow-down.

Cost of Products Sold. Cost of products sold were $37.3 million or 73.0% of sales for the three months ended December 31, 2009 compared to $35.0 million or 75.6% in the prior year comparative period. In the third quarter of 2009, cost of products sold were $38.4 million or 75.2% of sales.

Selling, General and Administrative. Selling, general and administrative expenses were $5.9 million (fourth quarter 2008, $5.9 million and third quarter 2009, $5.7 million) and were comprised primarily of sales commissions, marketing, corporate and administrative expenses.

Stock-based Compensation. Stock-based compensation expense was $0.2 million during the period (fourth quarter 2008, $0.2 million and third quarter 2009, $0.4 million) and reflected 157,626 restricted share unit awards to key employees.

EBITDA. As a result of the foregoing factors, EBITDA was $7.9 million in the fourth quarter of 2009 compared to $7.0 million in the third quarter of 2009 and $6.0 million in the fourth quarter of 2008.

Net income to EBITDA reconciliation:

(thousands of dollars, unaudited)	**Q4 2009**	**Q3 2009**	**Q4 2008**
Net income	$3,720	$3,467	2,778
Income tax	1,199	1,090	1,353
Foreign exchange (gain) loss	1,073	365	113
Interest expense	300	276	155
Amortization	1,441	1,350	1,307
Stock based compensation	152	419	260
EBITDA	$7,885	$6,967	$5,966

Operating Results by Business Segment

Landqart Mill

(thousands of dollars, except for shipments, unaudited)	Q4 2009	Q3 2009	Q4 2008
Sales	19,464	23,989	23,628
Operating income	2,183	1,844	1,244
Shipments (tonnes)	3,673	4,145	4,338

Dresden Mill

(thousands of dollars, except for shipments, unaudited)	Q4 2009	Q3 2009	Q4 2008
Sales	31,585	27,011	22,703
Operating income	5,110	4,661	4,156
Shipments (tonnes)	11,618	10,159	6,911

Year Ended December 31

Selected Financial Information and Statistics for the Twelve Months Ended:

(thousands of dollars, except for shipments, unaudited)	December 31, 2009	December 31, 2008	December 31, 2007
Sales	198,310	189,002	145,294
EBITDA[1]	25,583	25,027	13,611
Operating income	19,715	19,994	10,598
Net income	12,697	12,680	5,284
Shipments (tonnes)	56,499	53,221	52,093

[1]See net income to EBITDA reconciliation.

Analysis of Specific Items Affecting Comparability of Net Income

(thousands of dollars, except per share figures, unaudited)	December 31, 2009	December 31, 2008	December 31, 2007
Net income as reported	12,697	12,680	5,284
Foreign exchange loss (gain)	1,149	597	436
Adjusted net income	13,846	13,277	5,720
Net income per share (EPS), as reported	1.23	1.24	0.76
Impact of above item per share	0.11	0.06	0.06
Adjusted net income per share	1.34	1.30	0.82

Overview

At the Landqart mill the market for security papers continues to show strength and results were particularly influenced by higher margin banknote paper sales in the second half of the year. When compared to the prior year, current year results reflect weakness in the specialty papers which has been more than offset by strength in the security segment.

Landqart produces various security and specialty papers. Security paper production includes banknote paper which result in varying degrees of EBITDA margin depending on the complexity of the features included. During 2008 Landqart also started producing non-woven wallpaper base. Included in Landqart's sales number for the year ended December 31, 2009 is approximately 2,478 tonnes of non-woven wallpaper base. In December 31, 2008 approximately 732 tonnes of non-woven wallpaper base was sold.

At the Dresden mill, the wallpaper base market experienced strengthening orders throughout the year. Although sales tonnage has increased relative to the prior year, profitability is slightly lower at the Dresden mill due to product mix diversification. However, improved efficiencies on the paper-machine at the Dresden mill has provided us with strong margins despite the economic slowdown.

Sales. Sales for the year ended December 31, 2009 were higher relative to prior year primarily due to due to the product mix at the Landqart mill and continued strength at the Dresden mill.

Cost of Products Sold. Cost of products sold were $150.3 million or 75.8% of sales for the year ended December 31, 2009. In the year ended December 31, 2008 cost of products sold were $141.9 million or 75.1% of sales. Other than for Christmas holidays, security and wallpaper base operated at full capacity during the period.

Selling, General and Administrative. Selling, general and administrative expenses were $22.4 million for the year ended December 31, 2009 and $22.0 million in the year ended December 31, 2008.

Stock-based Compensation. Stock-based compensation expense was $1.0 million during the year ended December 31, 2009 (2008, $1.4 million).

EBITDA. As a result of the foregoing factors, EBITDA was $25.6 million for the year ended December 31, 2009 compared to $25.0 million for the year ended December 31, 2008.

Net income to EBITDA reconciliation:
(thousands of dollars, unaudited)

	December 31, 2009	**December 31, 2008**	**December 31, 2007**
Net income	12,697	12,680	5,284
Income tax	4,844	5,382	3,585
Other (income) expense	1,149	597	436
Interest expense	1,025	1,335	1,293
Amortization	4,887	3,645	2,105
Stock based compensation	981	1,388	908
EBITDA	$25,583	$25,027	$13,611

Operating Results by Business Segment

Landqart Mill

(thousands of dollars, except for shipments, unaudited)	December 31, 2009	December 31, 2008	December 31, 2007
Sales	84,675	83,432	63,281
Operating income	4,895	4,011	3,569
Shipments (tonnes)	15,666	17,700	16,268

Dresden Mill

(thousands of dollars, except for shipments, unaudited)	December 31, 2009	December 31, 2008	December 31, 2007
Sales	113,635	105,570	82,013
Operating income	19,282	20,007	9,614
Shipments (tonnes)	40,833	35,521	35,825

Financial Risk Management

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

Credit Risk

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

Cash and cash equivalents includes cash on deposit with an original maturity date of 90 days or less. In order to mitigate the risk of financial loss, cash on deposit is held with major Canadian and international financial institutions. The cash and cash equivalents balance at December 31, 2009 was $33.2 million (December 31, 2008 - $26.1 million). The Company does not have holdings in asset backed commercial paper.

The Company utilizes a combination of credit insurance and factoring to manage the risk associated with trade receivables. Approximately 88% 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 $0.2 million and is considered collectable. The Company's trade receivable balance at December 31, 2009 was $18.0 million (December 31, 2008 - $18.1 million).

Liquidity Risk

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

At December 31, 2009, the Company's accounts payable and accrued liabilities totaled $22.4 million (December 31, 2008 - $24.5 million), all of which fall due for payment within one year of the balance sheet date.

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

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

Market Risk

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

Interest rate risk:

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

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

Operating Activities

Fortress operates in a cyclical industry and its operating cash flows vary accordingly. Fortress' principal operating cash expenditures are for compensation, fibre, chemicals and debt service. Operating activities generated cash of $21.9 million in the year ended December 31, 2009 compared to $7.8 million in the year ended December 31, 2008.

In the fourth quarter of 2009, operating activities generated $14.0 million compared to $4.2 million used in the fourth quarter of 2008.

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 1.0107 and 1.5000, respectively, as at December 31, 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 year ended December 31, 2009 used cash of $9.7 million related to the purchase of plant and equipment at the mills and $0.5 million of deferred expenses. In the year ended December 31, 2008 investing activities used cash of $16.4 million related to the purchase of plant and equipment at the mills.

Investing activities in the fourth quarter of 2009 and 2008 used cash of $6.1 million and $2.9 million, respectively, primarily related to the purchase of plant and equipment at the mills.

Financing Activities

In the year ended December 31, 2009, financing activities used cash of $2.4 million related to a repayment of $8.1 million loan and $0.3 million capital lease somewhat offset by loan proceeds of $6.0 million. Financing activities in the year ended December 31, 2008 used cash of $12.8 million primarily related to the redemption of the convertible note ($8.2 million), repayment of capital leases, loans and operating loans ($9.8 million), and share repurchases ($0.7 million) partially offset by $5.9 million in additional financing.

Financing activities in the fourth quarter of 2009 used cash of $6.1 for repayment of loans and capital lease. In the fourth quarter of 2008 financing used cash of $1.5 million for the repayment of loans partially offset by $0.8 million proceeds from additional financing.

Related Party Transactions

In the year ended December 31, 2009, the Company, in the normal course of business, has paid or accrued office and administration expenses of $nil to a Company with a common director (2008 - $38).

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

Foreign Currency

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

Sensitivity analysis:

The Company has completed a sensitivity analysis to estimate the impact on net income for the period which a change in foreign exchange rates during the year ended December 31, 2009 would have had.

This sensitivity analysis includes the following assumptions:

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

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

	Impact on net income	
Change of +/- 1% in CHF foreign exchange rate	+/-	$ 175
Change of +/- 1% in Euro foreign exchange rate	+/-	$ 403

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

Limitations of sensitivity analysis

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

Outstanding Shares

The number of common shares outstanding at December 31, 2009 and the date of this report was 10,233,500. The number of options outstanding at December 31, 2009 and the date of this report was 740,175. At December 31, 2009 and the date of this report there were 157,626 restricted share units and 26,000 deferred share units outstanding.

Critical Accounting Estimates

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

Changes in Accounting Policies

Current Year

Effective January 1, 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.

Prior Year

Effective January 1, 2008, the Company adopted the Canadian Institute of Chartered Accountants' new Handbook Sections; 1535 "Capital Disclosures", 3031 "Inventories", 3862 "Financial Instruments – Disclosures" and 3863 "Financial Instruments – Presentation". Handbook Sections 3862 and 3863 replace Section 3861 "Financial Instruments – Disclosure and Presentation". These sections resulted in additional disclosures in the Company's financial statements.

Future Changes in Accounting Policy

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

Internal Controls Over Financial Reporting

The Chief Executive Officer and the Chief Financial Officer acknowledge responsibility for the design of internal controls over financial reporting ("ICFR"), and confirm that there were no changes in these controls that occurred during the year ended December 31, 2009 which materially affected, or are reasonably likely to materially affect, the Company's ICFR. Based upon their evaluation of these controls for the year ended December 31, 2009, the CEO and CFO have concluded that these controls are operating effectively.

Conversion to International financial reporting standards (IFRS)

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

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

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

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

Accounting Policy Impact and Decisions

Employee Benefits

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

Property, Plant and Equipment

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

Business Combinations

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

Provisions

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

Subsequent Event

On February 3, 2010 Fortress' wholly-owned subsidiary Dresden Papier GmbH ("Dresden") signed a factoring agreement of Dresden's accounts receivables in connection with the proposed rebuild of Landqart's paper-machine 1 ("PM 1") into a banknote paper-machine. The factoring facility is for up to EUR 12 Million (CDN $17.8M) commencing February 2, 2010 and extends over a three year period. The base rate for financing is 3 month Euribor (0.665% on February 2, 2010) + 2.25%.

The Dresden factoring facility and cash on hand, as well as proceeds from a factoring agreement to be entered into by Landqart AG and a new Dresden loan facility should provide the necessary financing and cash flow for the planned rebuild of PM1 to increase its production capacity from the current 2,500 tonnes per annum to approximately 10,000 tonnes per annum. Fortress Paper has signed a letter of intent which outlines the major terms for a Dresden loan facility and a Landqart factoring facility and is currently in the process of negotiating the definitive agreements.

Landqart's PM1 is currently utilized for lower margin specialty papers and low to medium security papers. The rebuild is expected to be completed by the end of 2010, with banknote paper production from this rebuilt machine scheduled to begin in the first quarter of 2011. Initial orders relating to proposed capital expenditures have been planned and initiated, subject to final confirmation.

Management's Outlook

Combining strong results from both mills this quarter has resulted in consecutive record quarterly EBITDA for Fortress. As the year has progressed our mills have weathered the economic crisis and produced continually better results throughout the year. Maintaining a strong balance sheet at a time the company is evaluating internal growth initiatives and accretive acquisition opportunities puts Fortress in an advantageous position.

The Dresden mill in particular has shown resilience through the economic crisis and progressively turned out improved results quarter over quarter. The Landqart mill has also performed well in the second half of the year coinciding with higher margin banknote paper production.

The market for security papers continues to show strength and the order book for wallpaper base has grown to its current level of eight weeks.

As news released October 14, 2009, Durasafe® banknote paper was officially launched at the Washington Banknote Conference held in December 2009. Currently several national banks are working on trials with Durasafe® banknote paper. Estimating the time to commercialization with prospective customers such as printers and national banks is dependent on a number of variables that are not within the Company's control. Some variables consist of the integration of other new and innovative security features and the timing of a new banknote series launch.

Durasafe® is an innovative banknote substrate, which consists of two 100% cotton paper layers, which contain all the security features common to traditional banknote paper but with a polymer core. This three layer substrate dramatically increases the durability and design options as compared to conventional paper banknotes. Durasafe® adds the unique ability to implement security features consisting of semi and fully transparent windows of different shapes, sizes and positions.

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)	Q4 2009	Q3 2009	Q2 2009	Q1 2009
Sales	51,049	51,000	49,638	46,623
Operating income	6,292	5,198	4,460	3,765
EBITDA	7,885	6,967	5,699	5,032
Net income	3,720	3,467	1,926	3,584
Basic EPS	$0.36	$0.34	$0.19	$0.35
Diluted EPS	$0.35	$0.34	$0.19	$0.35
Weighted average shares outstanding Basic (thousands)	10,234	10,234	10,234	10,234
Weighted average shares outstanding Diluted (thousands)	10,487	10,296	10,234	10,234
Average Swiss/Canadian exchange rate(1)	1.0341	1.0335	1.0498	1.0845
Average Euro/Canadian exchange rate (1)	1.5600	1.5699	1.5891	1.6226

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

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

FORTRESS PAPER LTD.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2009 and 2008

(Canadian dollars, amounts in thousands)

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Facsimile +1 604 806 7806

Auditors' Report

To the shareholders of
Fortress Paper Ltd.

We have audited the consolidated balance sheets of Fortress Paper Ltd. as at December 31, 2009 and 2008 and the consolidated statements of operations and comprehensive income and retained earnings (deficit), and cash flows for each of the years in the two year period ended December 31, 2009. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for each of the years in the two year period ended December 31, 2009 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Vancouver, BC
February 15, 2010

FORTRESS PAPER LTD.
CONSOLIDATED BALANCE SHEETS

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

	2009	2008
ASSETS		
Current		
Cash and cash equivalents	$ 33,205	$ 26,187
Trade accounts receivable	18,034	18,108
Other accounts receivable	2,614	3,846
Inventories *(note 5)*	26,880	31,968
Prepaid expenses	873	373
	81,606	80,482
Restricted cash	45	49
Deferred expenses	476	–
Property, plant and equipment *(note 6)*	47,852	43,536
Employee future benefits *(note 13)*	9,888	11,574
Total assets	$ 139,867	$ 135,641
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	22,447	24,502
Income taxes payable	4,446	5,455
Current portion of long-term debt *(note 7)*	5,378	6,831
	32,271	36,788
Long-term debt *(note 7)*	18,984	23,760
Future income taxes *(note 15)*	2,028	2,187
Total liabilities	$ 53,283	$ 62,735
Shareholders' equity *(note 8)*		
Share capital	59,083	59,083
Contributed surplus	3,088	2,107
Retained earnings	24,413	11,716
Total shareholders' equity	86,584	72,906
Total liabilities and shareholders' equity	$ 139,867	$ 135,641

Commitments and contingencies *(note 12)*
Subsequent event *(note 19)*

(See accompanying notes)

Approved by the Board of Directors:

"Chadwick Wasilenkoff" "Richard Whittall"

Director Director

FORTRESS PAPER LTD.

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

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

	2009	2008
Sales	$ 198,310	$ 189,002
Costs and expenses		
Cost of products sold	150,308	141,949
Amortization	4,887	3,645
Selling, general and administration	22,419	22,026
Stock-based compensation *(note 9)*	981	1,388
Operating income	19,715	19,994
Other income (expense)		
Interest, net *(note 14)*	(1,025)	(1,335)
Foreign exchange (loss)	(1,149)	(597)
Net income before income taxes	17,541	18,062
Income tax expense *(note 15)*	(4,844)	(5,382)
Net income and comprehensive income	$ 12,697	$ 12,680
Earnings per share		
Basic	$ 1.24	$ 1.24
Diluted	$ 1.23	$ 1.24
Weighted average number of shares outstanding		
Basic	10,233,500	10,249,286
Diluted	10,293,021	10,249,286

	2009	2008
Retained earnings (deficit)		
Balance — beginning of year	$ 11,716	$ (222)
Redemption of Convertible Note	–	(742)
Earnings	12,697	12,680
Balance — end of year	$ 24,413	$ 11,716
Accumulated other comprehensive earnings		
Balance — beginning and end of year	$ –	$ –

(See accompanying notes)

FORTRESS PAPER LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	2009	2008
Cash flows from operating activities		
Net income	$ 12,697	$ 12,680
Items not affecting cash:		
Amortization	4,887	3,645
Future income taxes	(159)	(221)
Foreign exchange (gain) loss on long term debt	(3,817)	6,842
Foreign exchange (gain) loss on operating loan	–	256
Foreign exchange (gain) loss on cash and cash equivalents	2,353	(2,328)
Stock based compensation	981	1,388
	16,942	22,262
Non-operating interest penalty *(note 8)*	–	950
Change in non-cash working capital items		
Trade accounts receivable	1,306	(7,277)
Inventories	5,088	(8,160)
Prepaid expenses	(500)	47
Other assets	1,686	(3,271)
Accounts payable and accrued liabilities	(2,602)	3,203
	21,920	7,754
Cash flows used by financing activities		
Redemption of Convertible Note, including penalties *(note 8)*	–	(8,176)
Repayment of long-term debt	(8,134)	(2,891)
Proceeds from long-term debt	6,022	5,941
Repayment of operating loans	–	(6,109)
Shares repurchased *(note 9)*	–	(662)
Payment on capital leases	(300)	(877)
	(2,412)	(12,774)
Cash flows used by investing activities		
Additions to property, plant and equipment	(9,665)	(16,423)
Deferred expenses	(476)	–
Restricted cash	4	(5)
	(10,137)	(16,428)
(Decrease) increase in cash position	9,371	(21,448)
Foreign exchange gain (loss) on cash and cash equivalents	(2,353)	2,328
Cash and cash equivalents, beginning of year	26,187	45,307
Cash and cash equivalents, end of year	$ 33,205	$ 26,187

Supplementary cash flow information *(note 17)*

(See accompanying notes)

1. NATURE OF OPERATIONS

Fortress Paper Ltd. (the "Company" or "Fortress") was incorporated on May 30, 2006 under the laws of the Province of British Columbia. From the date of incorporation to July 31, 2006 the Company was inactive. The Company's fiscal year end is December 31. Fortress owns and operates two paper mills, the Landqart mill located in Switzerland and the Dresden mill located in Germany. Fortress' security papers include banknote, passport and visa papers. The security papers produced at the Landqart mill incorporate internationally recognized overt and covert security features which are embedded into the paper and supplemented with customer-specific features. The Landqart mill has leveraged its extensive security papers competence to develop additional commercial applications using its in-house know-how and technology of security features to create innovative paper-based security products. Fortress' specialty papers business includes non-woven wallpaper base products, as well as graphic and technical papers. The Dresden mill produces coated and uncoated wallpaper base for wallpaper manufacturers.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

All significant intercompany transactions and balances have been eliminated.

Revenue and Related Cost Recognition

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

Estimates

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

Foreign Currency Translation

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

Cash and Cash Equivalents

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

Inventories

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

Property, Plant and Equipment

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

No amortization is charged on major improvements or expansions until the asset is ready for intended use. 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 (2008 – 8.9 years)

Income taxes

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

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

Earnings per share

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

Stock-based compensation

The Company has a stock option plan as described in note 9. 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.

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

3. CHANGES IN ACCOUNTING POLICIES

Current Year

Effective January 1, 2009, the Company adopted the Canadian Institute of Chartered Accountants' new Handbook Section 3064, "Goodwill and Intangible Assets". This section replaces CICA Handbook Section 3062, "Goodwill and Intangible Assets", and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of various preproduction and start-up costs and requires that these costs be expensed as incurred. The adoption of this new policy did not significantly impact the consolidated financial statements.

Prior Year

Effective January 1, 2008, the Company adopted the Canadian Institute of Chartered Accountants' new Handbook Sections; 1535 "Capital Disclosures", 3031 "Inventories", 3862 "Financial Instruments – Disclosures" and 3863 "Financial Instruments – Presentation". Handbook Sections 3862 and 3863 replace Section 3861 "Financial Instruments – Disclosure and Presentation". These sections resulted in additional disclosures in the Company's financial statements.

Future Changes in Accounting Policy

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

5. INVENTORIES

	2009	2008
Raw materials	$ 18,844	$ 17,018
Work in progress	519	869
Finished goods	7,517	14,081
	$ 26,880	$ 31,968

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

6. PROPERTY, PLANT AND EQUIPMENT

	2009		
	Cost	**Accumulated Amortization**	**Net Book Value**
Land and building	$ 10,254	$ 989	$ 9,265
Production and other equipment	46,554	10,008	36,546
Construction-in-progress	2,041	–	2,041
	$ 58,849	$ 10,997	$ 47,852

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

The net book value and accumulated amortization of capital leases included in production and other equipment was $952 and $774 respectively at December 31, 2009 and $1,066 and $660 respectively at December 31, 2008.

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

7. LONG-TERM DEBT AND OPERATING LOANS

Long-term debt

	2009	2008
Credit agreement with bank maturing 2014; interest at 2.65% and 4.5% secured by current assets (EUR 3,223 and 2008 - EUR 962)	$ 4,835	$ 1,640
Credit agreement with bank maturing 2010; interest at 4.5%, 3.8% and Libor + 2.5% secured by mortgage (CHF nil and 2008 - CHF 3,950)	–	4,532
Credit agreement with bank maturing 2012; interest at 4.8% unsecured (CHF 4,710 and 2008 – CHF 6,280)	4,760	7,204
Credit agreement with banks maturing 2010, 2011, 2013 and 2018; interest up to 3.1% and 4.9% secured by fixed assets (CHF 14,130 and 2008 – CHF 14,244)	14,281	16,340
Capital leases; interest at 4.7% (CHF nil and 2008 – CHF 19)	–	21
Capital leases; interest at 4.0% (EUR 324 and 2008 – EUR 501)	486	854
	24,362	30,591
Less: Current portion	(5,378)	(6,831)
	$ 18,984	$ 23,760

Principal repayments as at December 31, 2009 are required as follows:

	Long term debt	Capital lease	Total
2010	$ 5,113	$ 265	$ 5,378
2011	5,113	221	5,334
2012	4,749	—	4,749
2013	7,566	—	7,566
2014	1,289	—	1,289
Thereafter	46	—	46
	$ 23,876	$ 486	$ 24,362

Operating loans

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

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

8. 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 7*)	105,000	1,128	(600)
Balance, December 31, 2008	10,233,500	$ 59,083	$ 2,107
Stock compensation	—	—	981
Balance, December 31, 2009	10,233,500	$ 59,083	$ 3,088

Share Repurchase

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

Convertible Noted Redemption

During 2008 the Company held a senior secured convertible note in the principal amount of $7,500 that matured in August, 2011. The Convertible Note bore interest at an annual rate equal to the prime rate of a national Canadian bank, plus 2%. The Convertible Note was secured by a first security lien upon all or substantially all of the Company's assets. The Convertible Note was redeemable by the Company on or after August 1, 2009, in whole or in part, at 100% of the principal amount to be redeemed together with interest accrued theron up to but not including the redemption date.

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

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

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

9. STOCK BASED COMPENSATION

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

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

Stock Options

In June 2009, options were granted for 35,000 shares which vest over two years to an employee and officer of the Company. The weighted average fair vale of the options granted during 2009 was estimated at $2.98 per option (2008 - $2.57) at the grant date using the Black Scholes option pricing model. Option pricing models require the input of highly subjective assumptions including the expected volatility. Changes in the assumptions can materially affect the fair value estimate, and, therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options. Assumptions used in the pricing model 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

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

	Number of options	Exercise Price
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
Forfeiture May 25, 2009	(25,000)	$ 8.00
Cancelled June 10, 2009	(282,500)	8.00
Granted June 23, 2009	35,000	8.00
Balance, December 31, 2009	740,175	$ 8.00

As at December 31, 2009, 486,842 stock options were exercisable (December 31, 2008 – 535,117). No stock options were exercised during the year ended December 31, 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 December 31, 2009 is 2.8 years. The Company recorded $679 stock compensation expense and contributed surplus.

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

Deferred Share Unit Awards

A Deferred Share Unit ("DSU") is a right granted to a non-employee director to receive one common share of the Company, from treasury, on a deferred basis. The value of the DSUs, when redeemed, is equal to the market value of the shares on the redemption date, including the value of dividends paid on the Company's common shares, if any, as if they had been reinvested in additional DSUs on each payment date. The DSUs may only be redeemed upon a director's retirement from the Company. The Company recognizes the expense at the time of grant. On August 28, 2009, non-employee directors were awarded 26,000 units in aggregate. The Company recorded $185 stock compensation expense and contributed surplus. At December 31, 2009 there were 26,000 units outstanding.

Restricted Share Unit Awards

A Restricted Share Unit ("RSU") is a right granted to a key employee to receive one common share of the Company, from treasury, on a time vested basis. The fair value of restricted share awards is determined based upon the number of shares granted and the quoted price of the Company's stock on the date of grant. Restricted shares generally vest over three years. The company recognizes the expense on a straight-line basis over the vesting period. On August 28, 2009 and December 17, 2009 there were restricted share awards of 147,100 units and 10,526 units, respectively, to key employees. For the year ended December 31, 2009, $117 was recorded as stock compensation expense and contributed surplus. As at December 31, 2009, the total remaining unrecognized compensation cost related to RSUs amounted to $1,027, which will be amortized over their remaining vesting period.

10. CAPITAL DISCLOSURES

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

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

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

	December 31, 2009	December 31, 2008
Cash and cash equivalents	$ 33,205	$ 26,187
Less total debt	(24,362)	(30,591)
Net cash (debt)	$ 8,843	$ (4,404)
Shareholders' equity	$ 86,584	$ 72,906

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

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

11. RELATED PARTY TRANSACTIONS

In the year ended December 31, 2009, the Company, in the normal course of business, has paid or accrued office and administration expenses of $nil to a Company with a common director (2008 - $38).

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.

12. COMMITMENTS AND CONTINGENCIES

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

	2009
2010	$ 479
2011	379
2012	130
2013	99
2014	16
Thereafter	–
	$ 1,103

During 2009, the Dresden Papier mill received state and federal grants totaling EUR 794. In previous years, the Dresden Papier mill had received state and federal grants totaling EUR 6,350. As of December 31, 2009 the Company has accrued EUR 73 as a repayment obligation under the terms of the grants for overpayments in prior years (2008 – EUR 91). There are no additional repayment obligations as of December 31, 2009.

The Company has purchase obligations of EUR 602 for the future purchase of equipment.

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

13. EMPLOYEE FUTURE BENEFITS

The Company maintains a defined benefit pension plan in Switzerland providing pension benefits based on either length of service or earnings and length of service. The Company measures its accrued benefit obligations and fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation for the plan was December 31, 2007.

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

	2009	2008
Accrued benefit obligation		
Beginning of period	$ 64,654	$ 46,723
Service cost	1,520	1,423
Interest cost on accrued obligation	1,892	1,730
Benefit payments	(4,707)	(1,576)
Contributions by plan participants	1,237	1,155
Foreign exchange	(7,691)	15,199
End of year	$ 56,905	$ 64,654
Plan assets		
Fair value, beginning of period	$ 65,030	$ 55,992
Actual return on plan assets	5,565	(8,154)
Employer contributions	1,237	1,169
Employee contributions	1,237	1,155
Benefit payments	(4,707)	(1,576)
Foreign exchange	(7,864)	16,444
End of year	$ 60,498	$ 65,030
Funded status — plan surplus	$ 3,593	$ 378
Unamortized net actuarial loss	6,295	11,196
Accrued benefit asset	$ 9,888	$ 11,574

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

	2009	2008
Expense		
Current service cost	$ 1,519	$ 1,423
Interest cost	1,892	1,730
Actual (return) loss on plan assets	(5,565)	8,154
Expenses before adjustments	(2,154)	11,307
Difference between expected return and actual return on plan assets	3,228	(10,696)
Difference between net actuarial (gain) loss recognized and actual (gain) loss on benefit obligations	483	–
Net expense	$ 1,557	$ 611
Significant actuarial assumptions used are as follows	%	%
Discount rate to determine benefit obligations at end of year	3.3	3.3
Discount rate to determine benefit expense (income) for the year	3.3	3.3
Expected rate of return on plan assets	4.0	4.0
Rate of increase in future compensation	1.5	1.5
Plan assets at fair value at the end of the year	%	%
Liquid assets	3.7	3.7
Bonds	51.1	56.8
Equity — World	26.0	19.0
Real estate	19.2	20.5
	100.0	100.0

14. INTEREST, NET

	2009	2008
Interest expense	$ (1,121)	$ (2,492)
Interest expense on capital lease	(47)	(62)
Interest income	143	1,219
	$ (1,025)	$ (1,335)

Interest expense for 2008 includes $951 in interest penalties related to the redemption of the Convertible Note (note 7).

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

15. INCOME TAXES

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

	2009	2008
Future income tax assets (liabilities)		
Pension benefit	$ (2,028)	$ (2,187)
Non-capital loss carryforward	3,318	4,045
Property, plant and equipment	1,905	2,257
Share issue costs	539	840
Investments	1,750	1,820
Other	205	(714)
	5,689	6,061
Valuation allowance	(7,717)	(8,248)
Net future income tax liability	$ (2,028)	$ (2,187)

Non-capital loss carryforward consist of approximately $10,037 from our Landqart operations which expire beginning in 2010 through 2016 and $5,199 from Corporate which expire beginning in 2026 through 2029.

The components of income tax expense are as follows:

	2009	2008
Current	$ (5,003)	$ (5,603)
Future	159	221
	$ (4,844)	$ (5,382)

The reconciliation of income taxes calculated at the statutory rate of 30.00% to the actual income tax provision is as follows:

	2009	2008
Net income before income taxes	$ 17,541	$ 18,062
Income tax at statutory rates	5,262	5,599
Stock compensation and other non deductible expenses	303	344
Rate differentials between foreign jurisdictions, capital gains and future tax rates	(447)	2,221
Tax loss carryforward expired (used)	260	351
Change in valuation allowance	(534)	(3,133)
Income tax expense	$ 4,844	$ 5,382

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

16. SEGMENTED INFORMATION

The segmentation of the Company's manufacturing operations by mill is based on a number of factors, including production, production processes, and economic characteristics. The accounting policies for each mill are the same as those described in note 2. Landqart produces specialty and security papers while Dresden Papier produces non-woven wallpaper base products. During the year ended December 31, 2009, the Company earned revenue from one customer of $20,337 representing 10.2% of sales. During the year ended December 31, 2008, the Company earned revenue from one customer of $30,282 representing 16.0% of sales.

	2009			
	Dresden Papier (Germany)	Landqart (Switzerland)	Corporate (Canada)	Fortress Paper Consolidated
Sales	$ 113,635	84,675	—	$ 198,310
Operating earnings (loss)	$ 19,282	4,895	(4,462)	$ 19,715
Amortization	$ (2,313)	(2,574)	—	$ (4,887)
Stock-based compensation[1]	$ —	—	(981)	$ (981)
Capital expenditures	$ 5,865	3,336	—	$ 9,201
Property, plant and equipment	$ 20,206	27,646	—	$ 47,852
Sales by geographic area	%	%		%
Germany	44.8	16.1		32.5
Switzerland	—	22.6		9.6
Other Western Europe	24.0	41.4		31.5
Eastern Europe	28.7	11.7		21.5
Other	2.5	8.2		4.9
Total	100.0	100.0	—	100.0

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

	2008			
	Dresden Papier (Germany)	Landqart (Switzerland)	Corporate (Canada)	Fortress Paper Consolidated
Sales	$ 105,570	83,432	—	$ 189,002
Operating earnings (loss)	$ 20,007	4,011	(4,024)	$ 19,994
Amortization	$ (1,836)	(1,809)	—	$ (3,645)
Stock-based compensation[2]	$ —	—	(1,388)	$ (1,388)
Capital expenditures	$ 7,983	8,572	—	$ 16,555
Property, plant and equipment	$ 16,653	26,883	—	$ 43,536
Sales by geographic area	%	%		%
Germany	52.1	15.0		35.7
Switzerland	—	23.5		10.4
Other Western Europe	25.2	40.6		32.0
Eastern Europe	21.1	10.2		16.3
Other	1.6	10.7		5.6
Total	100.0	100.0	—	100.0

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

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

17. SUPPLEMENTARY CASH FLOW INFORMATION

Supplemental information		**2009**		**2008**
Interest paid	$	1,068	$	2,045
Income taxes paid	$	5,398	$	3,958

Non cash items

Change in non cash property, plant and equipment purchases included in accounts payable were $462 at December 31, 2009 and $131 at December 31, 2008

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

During the year ended December 31, 2008, there were 105,000 common shares of the Company issued as part of the redemption of the Convertible Note (note 7).

18. FINANCIAL INSTRUMENTS

Classification of Financial Instruments

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

Financial Risk Management

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

Credit Risk

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

Cash and cash equivalents includes cash on deposit with an original maturity date of 90 days or less. In order to mitigate the risk of financial loss, cash on deposit is held with major Canadian and international financial institutions. The cash and cash equivalents balance at December 31, 2009 was $33.2 million (December 31, 2008 - $26.1 million). The Company does not have holdings in asset backed commercial paper.

The Company utilizes a combination of credit insurance and factoring to manage the risk associated with trade receivables. Approximately 88% 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 $0.2 million and is considered collectable. The Company's trade receivable balance at December 31, 2009 was $18.0 million (December 31, 2008 - $18.1 million).

Liquidity Risk

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

At December 31, 2009, the Company's accounts payable and accrued liabilities totaled $22.4 million (December 31, 2008 - $24.5 million), all of which fall due for payment within one year of the balance sheet date.

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

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

Market Risk

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

Interest rate risk:

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

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

Currency risk:

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

For the years ended December 31, 2009 and 2008, the Company used derivative instruments to reduce its exposure to currency risk for sales not denominated in a local currency.

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

Sensitivity analysis:

The Company has completed a sensitivity analysis to estimate the impact on net income for the period which a change in foreign exchange rates or interest rates during the year ended December 31, 2009 would have had.

This sensitivity analysis includes the following assumptions:

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

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

	Impact on net income	
Change of +/- 1% in CHF foreign exchange rate	+/-	$ 175
Change of +/- 1% in EUR foreign exchange rate	+/-	$ 403

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

Limitations of sensitivity analysis

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

Derivative Instruments

During the years ended December 31, 2009 and December 31, 2008, the Company used derivatives for foreign exchange rates to reduce the exposure for certain sales made outside of local currencies.

During the year ended December 31, 2008, the Company entered into forward contracts to purchase USD over various dates at committed EUR/USD foreign exchange rates. There were no forward contracts outstanding as at December 31, 2009. As at December 31, 2008 the Company committed to buying a total of USD 1.500 over various dates between January, 2009 and June, 2009 at EUR/USD foreign exchange rates ranging from 1.4554 and 1.4644. The Company recognized $88 in other income for the year ended December 31, 2008 as a result of recording these forward contracts at the year-end market value.

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

19. SUBSEQUENT EVENTS

On February 3, 2010 Fortress' wholly-owned subsidiary Dresden Papier GmbH ("Dresden") signed a factoring agreement of Dresden's accounts receivable in connection with the proposed rebuild of Landqart's paper-machine 1 into a banknote paper-machine. The factoring facility is for up to EUR 12 Million (CDN $17.8M) commencing February 2, 2010 and extends over a three year period. The base rate for financing is 3 month Euribor (0.665% on February 2, 2010) + 2.25%.

Fortress Paper has also signed a letter of intent which outlines the major terms for a Dresden loan facility and Landqart factoring facility and is currently in the process of negotiating the definitive agreements.