FORTRESS PAPER LTD

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012 and 2011

(Canadian dollars, amounts in thousands)

FORTRESS PAPER LTD.
MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations of Fortress Paper Ltd. ("we", "our", "us", "Fortress" or the "Company") has been prepared based on information available as at March 8, 2013. The MD&A should be read in conjunction with the audited consolidated financial statements and the notes thereto for the year ended December 31, 2012 (available on SEDAR at www.sedar.com). This MD&A provides a review of the significant developments that have impacted the Company's performance during the quarter ended December 31, 2012 relative to the previous quarter and prior year comparative quarter, and the year ended December 31, 2012 relative to the year ended December 31, 2011. The financial information contained herein has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which as of January 1, 2011 is the required reporting framework for Canadian publicly accountable enterprises.

This MD&A contains certain forward-looking information that reflect the current views and/or expectations of the Company with respect to its expectations, beliefs, assumptions, estimates and forecasts about its business and the industry and markets in which it operates. The reader is cautioned that statements comprising forward-looking information are not guarantees of future performance and involve known and unknown risks, uncertainties, assumptions and other factors which are difficult to predict and that may cause actual results or events to differ materially from those anticipated in such forward-looking information. Accordingly, readers should not place undue reliance on forward-looking information. Examples of such forward-looking information that may be contained in this document include: growth and future prospects of our business; market conditions for dissolving pulp and our other products; expected returns on certain business segments; availability of funds for debt allocation; our perceptions of the industry and markets in which we operate and anticipated trends in such markets and in the countries in which we do business; benefits that may accrue to the Company as a result of certain acquisitions, capital expenditure programs and equipment upgrades; and the anticipated benefits of and completion dates for projects.

Assumptions underlying the Company's expectations regarding forward-looking information contained in this MD&A include, among others: that the Company will be able to effectively market its products; the ability of the Company to complete the ramp-up of its dissolving pulp production at the Fortress Specialty Cellulose mill to reach maximum capacity; the ability of the Company to realize additional savings and efficiencies at the Fortress Specialty Cellulose Mill from its "Operating Excellence" program; that there will be no further delays and disruptions affecting the completion of the Fortress Specialty Cellulose Mill cogeneration facility and that the Company will be able to commence timely delivery of power therefrom; that dissolving pulp will experience continued and improved demand in the marketplace at favorable prices; that the Landqart Mill will continue operating on a consistent and regular basis in order to produce and deliver on its banknote orders; the general stability of the economic, political and regulatory environments within the countries where the Company conducts operations; the ability of the Company to obtain financing (if necessary) on acceptable terms; that interest and foreign exchange rates will not vary materially from current levels; that all necessary arrangements will be finalized in a satisfactory manner in order to proceed with the Fortress Global Cellulose Mill project; and that our equipment will operate at expected levels.

Persons reading this MD&A are cautioned that statements comprising forward-looking information are only predictions, and that the Company's actual future results or performance are subject to certain risks and uncertainties including, without limitation: those relating to potential disruptions to production and delivery, including as a result of equipment failures, labour issues, the complex integration of processes and equipment and other factors; labour relations; failure to meet regulatory requirements; changes in the market; potential downturns in economic conditions; fluctuations in the price and supply of required materials; fluctuations in the market price for products sold; foreign exchange fluctuations; trade restrictions or import duties imposed by foreign governments; dependence on major customers; and other risk factors detailed in this MD&A under "Risks and Uncertainties" and our filings with the Canadian securities regulatory authorities. These risks, as well as others, could cause actual results and events to vary significantly. The Company does not undertake any obligation to release publicly any revisions for updating any forward-looking information, except as required by applicable securities law.

Throughout this discussion, reference is also made to EBITDA (defined as net income before interest, income taxes, depreciation, amortization, non-operating income and expenses, and stock-based compensation), which the Company considers to be an indicative measure of operating performance and a metric to evaluate profitability. Reference is also made to adjusted net (loss) income (calculated as net (loss) income less specific items affecting comparability with prior periods –

for the full calculation, see reconciliation included in the tables titled “Net Loss to Adjusted Net Loss Reconciliation”) and adjusted net income (loss) per share (calculated as adjusted net income (loss) divided by the weighted average number of shares outstanding in the period). EBITDA, adjusted net income (loss) and adjusted net income (loss) per share are not generally accepted earnings measures and should not be considered as an alternative to net income (loss) or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating these measures, the Company’s EBITDA, adjusted net income (loss) and adjusted net income (loss) per share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of EBITDA and adjusted net income (loss) to net income (loss) reported in accordance with IFRS are included in this MD&A.

The 2011 prior period comparative financial information throughout this report has been amended to conform with current period presentation, and prepared in accordance with IFRS. All references in this MD&A to “dollars” or “$” are to Canadian dollars, “€” are to the Euro currency unit, “CHF” are to Swiss francs and “US$” are to United States dollars.

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

Description of Business

The Company was incorporated on May 30, 2006 under the laws of the Province of British Columbia. The Company operates internationally in three distinct business segments: the Dissolving Pulp Segment, the Specialty Papers Segment and the Security Paper Products Segment. The Company operates its dissolving pulp business at the Fortress Specialty Cellulose mill located in Canada which is also in the process of expanding into the renewable energy generation sector with the construction of a cogeneration facility. The Company is also seeking to expand its dissolving pulp capacity with the recent acquisition of the Fortress Global Cellulose mill located at Lebel-sur-Quévillon, Québec, which the Company intends to convert into a dissolving pulp mill and re-start the cogeneration facility. The Company operates its specialty papers business at the Dresden mill located in Germany, where it is a leading international producer of specialty non-woven wallpaper base products. The Company operates its security paper products business at the Landqart mill located in Switzerland, where it produces banknote, passport, visa and other brand protection and security papers, and at its high security production and research facility located in Canada, where it manufactures optically variable thin film material (“OTM”). The segmentation of the Company’s manufacturing operations is based on a number of factors, including production, production processes, and economic characteristics. Fortress’ business segments were re-classified in 2012 given changes in the nature of products being produced.

Overall Performance

Fortress reported 2012 fourth quarter EBITDA of $0.5 million. For the third quarter of 2012, EBITDA loss was $6.4 million and for the fourth quarter of 2011, EBITDA loss was $1.5 million.

Fortress reported an adjusted net loss of $5.2 million, or diluted adjusted loss per share of $0.36 for the fourth quarter of 2012 on sales of $96.1 million. In the third quarter of 2012, the Company reported an adjusted net loss of $18.1 million or diluted adjusted loss per share of $1.26 on sales of $73.0 million and for the fourth quarter of 2011 adjusted net loss of $6.3 million or diluted loss per share of $0.44 on sales of $49.5 million.

Excluding corporate costs, the three business segments’ combined EBITDA was $1.1 million in the three months ended December 31, 2012. The Specialty Papers Segment contributed $9.3 million EBITDA, while the Dissolving Pulp Segment and the Security Paper Products Segment generated EBITDA losses of $3.5 million and $4.7 million, respectively. Corporate costs contributed to EBITDA loss in the amount of $0.6 million.

The Fortress Specialty Cellulose mill commenced production of dissolving pulp in early December 2011. Commercial production for accounting purposes, with the equipment operating as intended by management, began on March 18, 2012.

After such date all sales and cost of sales have been included in the operating results. The mill continued to make significant progress in production rate improvements and cost reductions. Dissolving pulp production volumes were at its highest level since the conversion of the mill into a producer of dissolving pulp. Despite promising operating results in November and December 2012, the mill has encountered challenging conversion issues which are intrinsic to a dissolving pulp mill ramp-up.

The Cogeneration project at the Fortress Specialty Cellulose mill is nearing completion, with engineering and procurement completed and overall construction in the final stages. However, commissioning and start-up activities have incurred delays as a result of various factors, including unforeseen piping related delays, reduced manpower availability and minor scope of work adjustments. The Company is in the process of commissioning and expects delivery of power to commence early in the second quarter of 2013. As previously reported, additional costs in the 10-20% range for the overall cogeneration project are anticipated. Hydro Quebec is aware of the postponement and the Company anticipates delivery of power pursuant to the power purchase agreement in the normal course.

The Specialty Papers Segment continued its strong performance in the fourth quarter and achieved record results in the 2012 fiscal year. Margins remain strong and the order log is healthy. Management believes that market demand will continue to be strong in the coming years. The displacement of traditional paper-based wallpaper with non-woven wallpaper base appears to be progressing faster than originally anticipated. Following completion of upgrades to our paper machine in the summer of 2012, production speed increased to a theoretical capacity of approximately 60,000 tonnes per year at the Dresden mill. Improvements in production efficiency, waste rates and the full utilization of the Company's new dry waste plant resulted in improved EBITDA margins.

There have been some positive developments in the Security Paper Products Segment such as new customers and the first order of substrate that included OTM. In December 2012, Morocco’s Central Bank purchased the first Durasafe® banknote printed on the Landqart mill's new composite paper-polymer-paper substrate Durasafe®. The Security Paper Products Segment otherwise experienced another challenging quarter, albeit slightly improved over preceding quarters. The Swiss Franc appreciation against the Euro has abated due to Swiss National Bank intervention; however, the strength of the Swiss Franc has been a disadvantage to the Landqart mill in terms of costs and expenses as a significant level of transactions are in Euro. Overcapacity continues to be an issue in the banknote paper market. The fierce competition for orders has led to a significant erosion of banknote prices and margins during 2012. Significant tenders in the near term should absorb some of the excess capacity. These less than favorable conditions have adversely impacted the results of the Security Paper Products Segment.

Fortress reported EBITDA loss of $5.3 million for the year ended December 31, 2012, compared to EBITDA of $3.3 million for the year ended December 31, 2011. Excluding corporate costs, the three business segments’ combined EBITDA was $0.1 million and $11.1 million in the years ended December 31, 2012 and 2011, respectively. Despite the economic challenges and uncertainty continuing in Europe during 2012, the Specialty Papers Segment contributed a record $37.5 million EBITDA which was significantly higher than the previous year at $31.4 million. The Security Paper Products Segment generated significant losses in 2012 ($21.7 million EBITDA loss) but improved slightly compared to the prior year ($23.1 million EBITDA loss). The Dissolving Pulp Segment, which continued ramping up, generated losses of $15.7 million EBITDA loss in 2012, compared to $2.8 million EBITDA in the year ended December 31, 2011. Corporate costs contributed to EBITDA loss in the amount of $5.4 million in 2012 and $7.8 million in 2011.

Adjusted net loss for the year ended December 31, 2012 was $37.4 million or ($2.60) per share (diluted). Adjusted net loss for the prior comparative period was $20.6 million or ($1.47) per share (diluted).

Management’s Outlook

Dissolving Pulp Segment

Dissolving pulp markets continued to soften during the fourth quarter of 2012 mainly due to excess supply of dissolving pulp as a result of new entrants. Dissolving pulp prices reached a low of approximately US$ 830-840 in December. Given current market conditions and in order to maintain good customer relations, our sales have and are intended to follow market prices with our three major Chinese customers, which are expected to be below the floor prices set in our supply agreements in the near term. Viscose staple fiber demand in China has improved recently, leading to improved prices for fiber and healthier capacity utilization. Dissolving pulp prices also have been improving since late December due to improved demand and concerns over the anti-dumping investigation initiated by the Ministry of Commerce of the People's Republic of China ("MOFCOM") against the United States, Brazil and Canada in February 2013 (see "Risks and Uncertainties"). However, we expect that dissolving pulp prices will remain under pressure due to new capacity expected to enter the market in the first half of 2013.

Cotton prices remained relatively stable in China during the fourth quarter of 2012 and have recently experienced significant price increases. However, when compared to 2011, cotton prices still remain low which could lead to possible cotton crop plantation reduction in 2013. Such cotton reserve management, particularly in China, may affect future cotton pricing.

The Fortress Specialty Cellulose mill continued to ramp up dissolving pulp production during the fourth quarter of 2012. Although the mill is not yet at long term target rates, improved stable operations is allowing management to focus on reducing costs. Inventory levels at year end were minimal and expected to remain low through the first quarter of 2013.

The Cogeneration project is in the commissioning and start-up phase. All major equipment suppliers are on site during this phase of the project. It is at this point that equipment is tested, repaired or adjusted and handed over to operations for care, custody and control. Turbine tests will commence in March and power generation connectivity to the electrical grid is expected early in the second quarter of 2013.

Although depressed dissolving pulp prices have impacted the Fortress Specialty Cellulose mill results, the Company is in the process of implementing a comprehensive "Operating Excellence" program designed to improve operating efficiency and productivity, and expects to realize additional savings and benefits once the cogeneration facility comes online.

The Fortress Global Cellulose mill project continues to progress with advancements in detailed engineering and process design for the conversion to dissolving pulp production. We expect to complete a final estimated work schedule in the second quarter of 2013. On-site, the workforce continues the refurbishing of the plant and equipment to bring the asset to full operational condition.

Specialty Papers Segment

The Specialty Papers Segment continues to perform well. The capital expenditure plan for 2012 was successfully completed during the general maintenance shutdown in August. The Dresden mill has now reached a manufacturing capacity of 60,000 tonnes per annum of non-woven wallpaper base.

Management believes that market demand will continue to grow and will remain strong in the coming years. The wallpaper market is expected to benefit from a recovery in residential construction and renovations markets as well as the displacement of traditional paper-based wallpaper with non-woven wallpaper base which appears to be progressing faster than originally anticipated.

Over the next two years, the Dresden mill will execute a capital expenditure program to increase capacity to 70,000 tonnes per year and improve quality.

Security Paper Products Segment

Market conditions for security papers remain difficult. While cotton and other raw material costs have stabilized and the Swiss Franc's appreciation against the Euro has been halted by Swiss National Bank intervention, the prevailing exchange rate to the Euro continues to place Landqart at a competitive disadvantage to other suppliers.

Overcapacity continues to be an issue in the banknote paper market. The fierce competition for orders has led to a significant erosion of banknote prices and margins. This has continued into 2013 and prices have continued to be under pressure in all major tenders over the last quarter. The commercial print market has also seen a steady erosion of prices as the printers' compete for market share, adding further downward pressure to prices in the banknote paper market.

Market demand remains stable and we expect demand for paper to follow historic trends in the coming year. However, as long as the imbalance remains between supply and demand, prices will remain low. The imbalance will only be corrected with further structural changes in the industry that lead to a reduction in production capacity. These difficult conditions have continued to impact the results of the Security Paper Products Segment.

Despite these difficulties Landqart has a strong order book with good visibility into the second half of the year. The mill is currently operating at full capacity. Estimated volumes to be produced and sold in 2013 are expected to be significantly higher than in 2012. Landqart has continued to win new customers and compete in tenders in new markets. In December 2012, Morocco's Central Bank purchased the first Durasafe® banknote printed on Landqart's new composite paper-polymer-paper substrate Durasafe®. This first note has resulted in considerable interest in the industry and Landqart is working on other opportunities including a confirmed second order.

The Landqart mill is now well into production of its most substantial contract and has now delivered over 50% of the contract. Management expects the contract to contribute to the optimization of the mill's operational efficiency over the remainder of the contract.

Significant Developments

Significant developments over the financial year ended December 31, 2012 included:

1. The acquisition of the Fortress Global Cellulose Mill in June 2012;

2. The issuance of an unsecured convertible debenture in the aggregate principal amount of $25 million to Fonds de Solidarite ("FSTQ") in connection with the acquisition of the Fortress Global Cellulose mill (see "Offering of Debentures");

3. The completion of a $69 million short form prospectus offering of 7.0% convertible unsecured subordinated debentures in July 2012 (the "2012 Debenture Offering"), including the exercise in full of the underwriters' over-allotment option (see "Offering of Debentures").

4. Continued strength in margins at the Dresden mill and the successful completion of the 2012 capital expenditure program increasing manufacturing capacity of non-woven wallpaper base to 60,000 tonnes per annum.

5. The sale by the Landqart Mill of the first Durasafe® banknote now in circulation and the first order of substrate that included OTM.

6. Continued improvement of the Fortress Specialty Cellulose mill's dissolving pulp operations. Production rates and costs per tonne have improved significantly over the year.

7. The re-instatement of the Landqart mill's most substantial contract which is expected to contribute to the optimization of the mill's operational efficiency over the next year.

Acquisition of Fortress Global Cellulose Mill

In June 2012, Fortress completed the acquisition, through its wholly owned subsidiary, Fortress Global Cellulose Ltd. ("Fortress Global"), of the Fortress Global Cellulose mill from Domtar Inc., pursuant to which Fortress Global acquired the buildings, equipment and other ancillary assets relating to the mill, including a 30 megawatt non-operating cogeneration facility. 9109-3294 Québec Inc. ("9109"), a wholly owned subsidiary of the Québec Ministère du Développement economique, de l'Innovation et de l'Exportation, acquired the lands relating to the mill. The Company paid a nominal cash amount and agreed to make contributions pursuant to a trust agreement in escalating tranches over the next five years of an aggregate of $7.5 million and an additional contingent amount of $2.5 million only in the event of a permanent closing of the Fortress Global Cellulose mill in respect of environmental remediation costs (see "Critical Accounting Estimates"). The Company intends to invest estimated capital expenditures of approximately $222 million over the next two to three years to convert the mill into a low cost, high quality dissolving pulp operation initially targeting viscose fibre products, and to restart the cogeneration facility which will produce green energy and result in material net energy savings, an improvement to operating income. The Company has also identified certain modifications to the cogeneration facility that are expected to increase the power to 34 megawatts. The Fortress Global Cellulose mill is planned to have an annual production capacity of viscose grade dissolving pulp of approximately 250,000 air dried metric tonnes (“ADMT”).

Concurrent with the completion of the acquisition of the Fortress Global Cellulose mill, the Company finalized a $132.4 million project financing loan with Investissement Québec ("IQ"). The loan is comprised of two tranches. The first tranche of $102.4 million has a term of 10 years and the second tranche of $30 million has a term of three years. The loan is secured by the capital assets of Fortress Global and accrues interest at a fixed rate of 5.0% per annum for the first five years, followed by a rate not to exceed 5.5% per annum for the remaining five years. Equity compensation in the form of 715,000 share purchase warrants of the Company, exercisable at a price of $21.52 per common share on the earlier of December 31, 2014 and the date on which the loan has been fully disbursed, and expiring on December 31, 2017, was also provided to IQ in connection with the loan. Fortress Global has not yet drawn down on this loan. The Company also issued an unsecured convertible debenture in the aggregate principal amount of $25 million (the “FSTQ Debenture”) to Fonds de Solidarité FTQ (“FSTQ”), which matures in five years and bears interest at a rate of 7% per annum. The FSTQ Debenture is convertible, in whole or in part, into common shares of the Company at a conversion price of $32.28.

On October 1, 2012, the Company announced that it had entered in an electricity supply agreement with Hydro Québec for the sale of green electricity to be produced at the Fortress Global Cellulose Mill's cogeneration facility upon its re-start. Under the terms of the agreement, the Fortress Global Cellulose Mill will provide up to 34 megawatts of green power to Hydro Québec commencing no later than June 1, 2014, at a price of $106 per megawatt hour, indexed to the consumer price index over a 25 year term.

Offering of Debentures

In July 2012, the Company completed the 2012 Debenture Offering, including the exercise in full of the underwriters’ over-allotment option, resulting in aggregate gross proceeds of $69 million. The debentures are listed and posted for trading on the Toronto Stock Exchange under the symbol “FTP.DB.A”. Holders of debentures may, at their option, convert debentures into common shares of the Company at any time prior to December 31, 2019 at a price of $31.00 per share.

Net proceeds received from the 2012 Debenture Offering were approximately $65.5 million. Fortress has used net proceeds substantially as intended with the exception of the $15 million allocation to fund capital expenditures relating to its Fortress Global Cellulose mill. Approximately $7 million of these funds were redeployed to the Fortress Specialty Cellulose mill operations and cogeneration project. Funds generated from the Company’s overall operations will be reallocated to the capital expenditures relating to its Fortress Global Cellulose mill in the normal course of business as required. Accordingly, such redeployment of net proceeds is not expected to impact the Company’s Fortress Global Cellulose mill project.

The Company also issued an unsecured convertible debenture in the aggregate principal amount of $25 million (the “FSTQ Debenture”) to FSTQ, which matures in five years and bears interest at a rate of 7% per annum. The FSTQ Debenture is convertible, in whole or in part, into common shares of the Company at a conversion price of $32.28.

Subsequent Event

Subsequent to the fiscal period ended December 31, 2012, the Company through its wholly-owned subsidiary, Dresden Papier GmbH (“Dresden Papier”), entered into two credit facilities in the aggregate amount of €15 million (approximately $20.25 million) with Commerzbank AG. The new facilities are comprised of a €5 million (approximately $6.75 million) tranche and a €10 million (approximately $13.5 million) tranche which have an interest rate of three-month EURIBOR plus 3.1% per annum and mature in March 2016 and March 2018, respectively. Proceeds will be used for working capital and general corporate purposes.

Selected Quarterly Information

(thousands of dollars, except per share amounts, exchange rates and shares outstanding, unaudited)	**Q4 2012**	**Q3 2012**	**Q2 2012**	**Q1 2012**
Sales	96,096	72,952	84,023	61,368
Operating (loss) income	(5,216)	(14,857)	(3,075)	(6,220)
EBITDA[(1)]	530	(6,403)	2,344	(1,813)
Net (loss) income	(3,955)	(18,900)	12,461	(10,493)
Basic net (loss) income per share	($0.27)	($1.31)	$0.87	($0.73)
Diluted net (loss) income per share	($0.27)	($1.31)	$0.83	($0.73)
Weighted average shares outstanding Basic (thousands)	14,492	14,394	14,322	14,306
Weighted average shares outstanding Diluted (thousands)	14,492	14,394	15,118	14,306
Average Swiss/Canadian exchange rate[(2)]	1.0645	1.0340	1.0784	1.0871
Average Euro/Canadian exchange rate[(2)]	1.2857	1.2445	1.2956	1.3129
Average US dollar/Canadian exchange rate[(2)]	0.9913	0.9953	1.0105	1.0011

(thousands of dollars, except per share amounts, exchange rates and shares outstanding, unaudited)	**Q4 2011**	**Q3 2011**	**Q2 2011**	**Q1 2011**
Sales	49,524	83,995	89,905	85,489
Operating (loss) income	(5,604)	(4,876)	617	(3,100)
EBITDA[(1)]	(1,492)	(758)	4,599	951
Net (loss) income	(9,171)	(7,237)	2,905	(5,727)
Basic net (loss) income per share	($0.64)	($0.51)	$0.20	($0.43)
Diluted net (loss) income per share	($0.64)	($0.51)	$0.19	($0.43)
Weighted average shares outstanding Basic (thousands)	14,298	14,260	14,232	13,417
Weighted average shares outstanding Diluted (thousands)	14,298	14,260	15,145	13,417
Average Swiss/Canadian exchange rate[(2)]	1.1216	1.1911	1.1147	1.0476
Average Euro/Canadian exchange rate[(2)]	1.3790	1.3843	1.3937	1.3497
Average US dollar/Canadian exchange rate[(2)]	1.0232	0.9807	0.9679	0.9855

(1) See Operating (loss) income to EBITDA reconciliation.
(2) Source – Bank of Canada (average noon rate for the period).

Operating (loss) income to EBITDA Reconciliation:

(thousands of dollars, except per share amounts, exchange rates and shares outstanding, unaudited)	Q4 2012	Q3 2012	Q2 2012	Q1 2012
Operating (loss) income	(5,216)	(14,857)	(3,075)	(6,220)
Amortization	5,116	5,131	4,920	3,997
Stock-based compensation	630	1,977	499	410
Dispute resolution accrual	-	1,346	-	-
EBITDA	530	(6,403)	2,344	(1,813)

(thousands of dollars, except per share amounts, exchange rates and shares outstanding, unaudited)	Q4 2011	Q3 2011	Q2 2011	Q1 2011
Operating (loss) income	(5,604)	(4,876)	617	(3,100)
Amortization	3,793	3,668	3,394	3,508
Stock-based compensation	319	450	588	543
EBITDA	(1,492)	(758)	4,599	951

Fluctuations in quarterly results reflect significant transactions and developments within the Company. In the second quarter of 2011, the Dissolving Pulp Segment realized significantly higher prices for specialty pulp relative to the first and third quarters of 2011. In the fourth quarter of 2011, the Dissolving Pulp Segment was re-defined as the Fortress Specialty Cellulose Mill transitioned from a northern bleached hardwood kraft (“NBHK”) and specialty pulp producer to a dissolving pulp producer. Results were impacted by the mill being in either shutdown or ramp-up mode for much of the fourth quarter of 2011 with production of dissolving pulp commencing in December 2011. Ramp-up continued through the first quarter of 2012 with all dissolving pulp revenue and costs for production from December 2011 through March 18, 2012 being capitalized in property, plant and equipment for accounting purposes. Throughout the remainder of 2012, the Dissolving Pulp Segment continued improving production rates albeit at a slower pace than first anticipated. In the third quarter of 2012, the Fortress Specialty Cellulose mill had its annual extended maintenance shutdown, as well as an unplanned outage due to a temporary recovery boiler issue which both contributed to lower shipments and production during the quarter. During the fourth quarter of 2012, the Dissolving Pulp Segment saw stable production with the highest volumes of dissolving pulp produced during a quarter to date. As such, sales were higher, but continued deterioration in dissolving pulp prices impacted earnings to overshadow improved production.

Product mix, high raw material costs, pricing pressure, a strong Swiss currency, and less than optimal production efficiency at the Landqart mill contributed to a disappointing and difficult 2011 year for the Security Paper Products Segment which materially impacted the Company’s quarterly results throughout 2011 and 2012. Net income for the second quarter of 2012 was significantly impacted by the sale of the hydropower assets and associated real estate at the Landqart mill to a Swiss utility company for proceeds of CHF18 million.

The Specialty Papers Segment continues to produce stable, strong results, with the last quarter of 2012 posting record results to date primarily as a result of increased, efficient production and stable margins.

Fourth Quarter 2012 Earnings Review

Three Months Ended December 31

Overview

Reported EBITDA for the Company was $0.5 million for the three months ended December 31, 2012. For the three months ended September 30, 2012, EBITDA loss was $6.4 million and for the three months ended December 31, 2011 EBITDA loss was $1.5 million.

Selected Financial Information and Other Data

(thousands of dollars, except shipments, unaudited)	Q4 2012	Q3 2012	Q4 2011
Sales	96,096	72,952	49,524
EBITDA[1]	530	(6,403)	(1,492)
Operating loss	(5,216)	(14,857)	(5,604)
Net loss	(3,955)	(18,900)	(9,171)
Adjusted net loss[2]	(5,248)	(18,066)	(6,273)
Paper shipments (tonnes)[3]	16,382	15,201	13,035
Pulp shipments (ADMT)	46,909	30,561	8,168

(1) See Net Loss to EBITDA Reconciliation.
(2) See Net Loss to Adjusted Net Loss Reconciliation.
(3) Includes shipments of security and specialty paper products by the Landqart and Dresden mills.

Net Loss to Adjusted Net Loss Reconciliation:

(thousands of dollars, except per share amounts, unaudited)	Q4 2012	Q3 2012	Q4 2011
Net loss	(3,955)	(18,900)	(9,171)
Foreign exchange loss (gain)	(1,293)	834	2,898
Adjusted net loss	(5,248)	(18,066)	(6,273)
Basic net loss per share	($0.27)	($1.31)	($0.64)
Diluted net loss per share	($0.27)	($1.31)	($0.64)
Adjusted net loss per share, basic	($0.36)	($1.26)	($0.44)
Adjusted net loss per share, diluted	($0.36)	($1.26)	($0.44)

Net Loss to EBITDA Reconciliation:

(thousands of dollars, unaudited)	Q4 2012	Q3 2012	Q4 2011
Net loss	(3,955)	(18,900)	(9,171)
Income tax	(3,321)	(1,354)	(388)
Foreign exchange loss (gain)	(1,293)	834	2,898
Net finance expense	3,353	4,563	1,057
Amortization	5,116	5,131	3,793
Stock-based compensation	630	1,977	319
Dispute resolution accrual	-	1,346	-
EBITDA	530	(6,403)	(1,492)

Fortress reported adjusted net loss of $5.2 million, or diluted adjusted net loss per share of $0.36 for the fourth quarter of 2012 on sales of $96.1 million. In the third quarter of 2012, the Company reported an adjusted net loss of $18.1 million or diluted adjusted net loss per share of $1.26 on sales of $73.0 million and for the fourth quarter of 2011 adjusted net loss of $6.3 million or diluted adjusted net loss per share of $0.44 on sales of $49.5 million.

Sales were higher and adjusted net loss was lower in the fourth quarter of 2012 compared to the prior comparative quarters primarily due to improvements in all three segments. In the prior quarter, there was a scheduled annual extended maintenance shutdown and an unplanned shutdown experienced in the Dissolving Pulp Segment. Combined, the maintenance and unplanned shutdowns resulted in a reduction of production of approximately 5,000 ADMT of dissolving pulp. In the prior year comparative period, the Dissolving Pulp Segment was shut down pending completion of the conversion project.

At our Dresden Mill, sales increased as a result of continued productivity gains following completion of capital expenditure programs earlier in the year which resulted in increased capacity. At our Landqart mill, shipments of the large re-instated banknote order were made throughout the fourth quarter of 2012. The first shipment of Durasafe® also took place in December 2012, contributing to increased sales.

Cost of products sold were $87.5 million or 91.1% of sales for the three months ended December 31, 2012 compared to $71.4 million or 97.8% in the third quarter of 2012. In the fourth quarter of 2011, cost of products sold were $41.4 million or 83.6% of sales. Cost of products sold increased significantly in the fourth quarter of 2012 compared to the prior quarter and prior year comparative quarter due to increased sales and production tonnage. In the prior year comparative quarter, there was a shutdown of the Fortress Specialty Cellulose mill pending completion of the conversion project, and dissolving pulp sales and cost of sales were capitalized during this period.

Selling, general and administrative (“SG&A”) expenses were $8.1 million for the fourth quarter of 2012 compared to $9.3 million for the third quarter of 2012. The prior year comparative SG&A was $9.6 million. The decreased level of SG&A relative to the prior quarter was due in part to reduced activity at the corporate level after the successful acquisition of the Fortress Global Cellulose mill in the second quarter of 2012.

Stock-based compensation expense was $0.6 million during the fourth quarter of 2012 compared to $2.0 million in the third quarter of 2012. The prior year comparative period stock-based compensation was $0.3 million. The increase in stock-based compensation in the third quarter of 2012 was a result of executive and management awards made under the Company's long term incentive plan and awarded primarily in connection with the successful completion of the purchase of the Fortress Global Cellulose mill.

Operating Results by Business Segment

Dissolving Pulp Segment

(thousands of dollars, except for shipments, unaudited)	**Q4 2012**	**Q3 2012**	**Q4 2011**
Sales	35,764	25,561	(1,953)
Operating loss	(5,776)	(10,314)	(2,207)
Shipments (ADMT)	46,909	30,561	8,168

Sales are presented net of logistic costs which include shipping, handling and other costs that are expenses of the sales agent. Sales in the fourth quarter of 2012 include net sales from inventory of 4,614 ADMT. Pricing continued to weaken from the previous quarter due to generally weak dissolving pulp and viscose markets.

During the fourth quarter of 2012, the Fortress Specialty mill continued making progress in improving production rates and reducing costs. Despite a slower than anticipated ramp-up following the scheduled maintenance and unplanned shutdowns in the previous quarter, which impacted productivity early in the fourth quarter, the mill’s production volume in the fourth quarter was at its highest level since the conversion of the mill into a dissolving pulp operation was completed. During the quarter, significant improvements in costs were realized when the mill ran in excess of 500 ADMT per day for extended periods. In addition, compared to the previous quarter, dissolving pulp sales revenues were lower primarily due to lower dissolving pulp prices resulting from challenging dissolving pulp and viscose markets.

In the prior year comparative period, the Fortress Specialty Cellulose mill primarily produced specialty pulp and exited as a producer of dissolving pulp having delivered its first 966 ADMT. During much of the fourth quarter of 2011, the mill was in a ramp-up phase, whereby approximately $15.7 million of costs, net any sales, were capitalized as property, plant and equipment. Sales in the fourth quarter of 2011 also included 11,700 ADMT of commissioned sales of pulp not produced at the mill; however, the Company was required to repurchase certain specialty pulp sold in the prior quarter which resulted in a sales deficit of approximately $2.0 million. The repurchased specialty pulp was subsequently re-sold after the year-end.

Specialty Papers Segment

(thousands of dollars, except for shipments, unaudited)	Q4 2012	Q3 2012	Q4 2011
Sales	37,349	34,695	34,881
Operating income	8,448	7,389	8,172
Shipments (tonnes)	14,694	13,994	11,990

Shipment volume in the fourth quarter of 2012 continued a positive trend, primarily due to the implementation of capital programs earlier in the year that resulted in increased capacity of approximately 10%. Margins remained relatively stable compared to the prior comparative periods. Included in shipments in the third and fourth quarters of 2012 were 926 tonnes and 925 tonnes, respectively, of commissioned sales not produced at the Dresden mill ("Commissioned Sales"). In the prior year comparative period, shipments included 707 tonnes of Commissioned Sales.

Security Paper Products Segment

(thousands of dollars, except for shipments, unaudited)	Q4 2012	Q3 2012	Q4 2011
Sales	22,983	12,696	16,596
Operating loss	(6,665)	(8,872)	(9,205)
Shipments (tonnes)	1,688	1,207	1,045

The production of a previously delayed significant banknote order commenced during the third quarter of 2012 after it was re-instated and continued in the fourth quarter. An increase in operating efficiency is expected as a result of this increase in volume as waste rates decline and the process is optimized.

Results in the fourth quarter of 2012 continue to be impacted by headwinds of a strong Swiss Franc, high raw material costs, and less than optimal production efficiency on the paper machines at the Landqart mill, in part as a result of the postponement of several major currencies. The Company continues to assess other strategic options at the Landqart mill, including the sale of non-core assets and expanding product mix.

Fortress Optical Features Ltd. ("Fortress Optical") generated sales of $0.1 million in the fourth quarter of 2012 compared to $0.4 million in the third quarter of 2012 and $0.9 million in the fourth quarter of 2011. Fortress Optical produces security material for the security threads used in banknotes.

Year Ended December 31

Selected Financial Information and Other Data for the Year Ended:

(thousands of dollars, except for shipments, unaudited)	December 31, 2012	December 31, 2011	December 31, 2010
Sales	314,439	308,913	281,287
EBITDA(1)	(5,342)	3,300	25,888
Operating (loss) income	(29,368)	(12,963)	1,342
Net (loss) income	(20,887)	(19,230)	33,865
Adjusted net (loss) income(2)	(37,425)	(20,625)	8,222
Total assets	577,954	491,309	306,613
Long-term debt	248,140	137,949	45,758
Pulp shipments (ADMT)	148,831	174,383	141,355
Paper shipments (tonnes)(3)	63,431	57,070	64,568

(1) See Net (Loss) Income to EBITDA Reconciliation.
(2) See Net (Loss) Income to Adjusted Net (Loss) Income Reconciliation.
(3) Includes shipments of security and specialty paper products by the Landqart and Dresden mills.

Net (Loss) Income to EBITDA Reconciliation:

(thousands of dollars, unaudited)

	December 31, 2012	December 31, 2011	December 31, 2010
Net (loss) income	(20,887)	(19,230)	33,865
Income tax	(4,287)	3,939	6,220
Foreign exchange loss (gain)	144	(1,395)	2,237
Gain on sale of property, plant and equipment	(19,297)	-	-
Dispute resolution accrual	1,346	-	-
Fair value gain on acquisition	-	-	(41,804)
Start-up costs	-	-	3,368
Interest expense	14,959	3,723	824
Amortization	19,164	14,363	8,584
Stock based compensation	3,516	1,900	7,594
Executive cash award	-	-	5,000
EBITDA	(5,342)	3,300	25,888

Net (Loss) Income to Adjusted Net (Loss) Income Reconciliation:

(thousands of dollars, except per share amounts, unaudited)	December 31, 2012	December 31, 2011	December 31, 2010
Net (loss) income	(20,887)	(19,230)	33,865
Foreign exchange loss (gain)	144	(1,395)	2,237
Gain on sale of property plant and equipment	(19,297)	-	-
Long-term debt prepayment penalty	2,615	-	-
Fair value gain on acquisition	-	-	(41,804)
Start-up costs	-	-	3,368
Executive special bonus payment	-	-	10,556
Adjusted net (loss) income	(37,425)	(20,625)	8,222
Basic net (loss) income per share	(1.45)	(1.37)	3.00
Diluted net (loss) income per share	(1.45)	(1.37)	2.74
Adjusted net (loss) income per share, basic	(2.60)	(1.47)	0.73
Adjusted net (loss) income per share, diluted	(2.60)	(1.47)	0.67

Overview

EBITDA loss for the Company was $5.3 million for the twelve months ended December 31, 2012 on sales of $314.4 million compared to EBITDA of $3.3 million in the twelve months ended December 31, 2011 on sales of $308.9 million. Record annual results for the Dresden mill were offset by the challenges experienced by the Landqart mill and the continued ramp-up and optimization activities at the Fortress Specialty Cellulose mill. See “Operating Results by Business Segment”.

Excluding corporate costs, the three business segments’ combined EBITDA was $0.1 million and $11.1 million in the years ended December 31, 2012 and 2011, respectively. Despite the economic challenges and uncertainty continuing in Europe during 2012, the Specialty Papers Segment contributed a record $37.5 million EBITDA which was significantly higher than the previous year at $31.4 million. The Security Paper Products Segment generated $21.7 million EBITDA loss in 2012 which was a slight improvement relative to the prior year ($23.1 million EBITDA loss). The Dissolving Pulp Segment which continued ramping up, generated a $15.7 million EBITDA loss in 2012, compared to $2.8 million EBITDA in 2011. Corporate costs contributed to EBITDA loss in the amount of $5.4 million in 2012 and $7.8 million in 2011.

Adjusted net loss for the year ended December 31, 2012 was $37.4 million or ($2.60) per share (diluted). Adjusted net loss for the prior comparative period was $20.6 million or ($1.47) per share (diluted).

Total shipments of paper products produced by the Landqart mill and the Dresden mill were higher in 2012 compared to 2011 due primarily to the postponement of production in 2011 associated with the conversion of the Landqart mill from a specialty paper mill to a higher margin banknote and security paper mill, and the increased sales and capacity at the Dresden Mill in 2012 compared to the previous year.

The Fortress Specialty Cellulose mill commenced production of dissolving pulp in early December 2011 and the mill continued to ramp-up its production of dissolving pulp throughout 2012. Commercial production for accounting purposes, with the equipment operating as intended by management, began on March 18, 2012. After such date all sales and cost of sales have been included in the operating results. In 2011, sales reflect nearly 10 months of operations and include NBHK pulp and specialty pulp production at the Fortress Specialty Cellulose mill.

Cost of products sold was $284.8 million or 90.6% of sales for the twelve months ended December 31, 2012 compared to $268.2 million or 86.8% in the twelve months ended December 31, 2011. The increased percentage of cost of products to sales was primarily impacted by the performance of the Dissolving Pulp Segment (see "Operating Results by Business Segment – Dissolving Pulp Segment", below).

SG&A expenses remained generally consistent at $36.3 million in 2012 compared to $37.4 million in 2011.

Stock-based compensation expense was $3.5 million during the year ended December 31, 2012 compared to $1.9 million in the previous year. The increase in stock-based compensation in 2012 is a result of executive and management awards made under the Company's long term incentive plan and awarded primarily in connection with the successful completion of the purchase of the Fortress Global Cellulose mill in June 2012.

The Company recorded income tax recoveries of $4.3 million in 2012, comprised of $9.1 million current tax expense offset by $13.4 million in future income tax recovery, compared to a $3.9 million income tax expense in 2011 comprised of $8.1 million current tax expense offset partially by $4.2 million in future income tax recovery. For both years, current tax expense was primarily a result of the profitability experienced in the Specialty Papers Segment. The amount recognized as future income tax recovery in 2012 and 2011 mainly represents an increase to deferred income tax assets for recognition of tax loss carry forwards partially offsetting the increase in deferred tax liabilities for movement in property, plant and equipment timing differences and other deferred tax liability movements charged directly to equity.

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

Operating Results by Business Segment

Dissolving Pulp Segment

(thousands of dollars, except for shipments, unaudited)	**December 31, 2012**	**December 31, 2011**	**December 31, 2010**
Sales	106,857	110,481	85,768
Operating (loss) income	(23,603)	(692)	3,035
Operating (loss) income adjusted for start-up	(23,603)	(692)	6,403
Shipments (ADMT)	148,831	174,383	141,355

Results for the year ended December 31, 2012 reflect a continued ramp-up period of dissolving pulp production at the Fortress Specialty Cellulose mill. Commercial production for accounting purposes, with the equipment operating as intended by management, began on March 18, 2012. After such date all sales and cost of sales are included in the operating results.

Results for the year ended December 31, 2011 reflect efforts made to produce specialty pulp to maximize returns while training employees and completing equipment upgrades required for the conversion of the Fortress Specialty Cellulose mill to a dissolving pulp mill, including the necessary shut down of the mill for the final phase of the conversion project. The final shutdown phase began in mid-October and, after a temporary work delay, the mill initiated the final stages of the conversion project and began production of dissolving pulp by early December.

Throughout 2012 and on a going forward basis, the Fortress Specialty Cellulose mill and any future dissolving or specialty pulp manufacturing facility will represent the Dissolving Pulp Segment of the Company's business. This was previously disclosed as the Pulp Segment.

Specialty Papers Segment

(thousands of dollars, except for shipments, unaudited)	**December 31, 2012**	**December 31, 2011**	**December 31, 2010**
Sales	150,516	144,226	122,316
Operating income	34,026	28,353	20,576
Shipments (tonnes)	58,773	52,503	48,032

Tonnes shipped in the twelve months ended December 31, 2012 were approximately 12% higher than the comparable prior year period primarily due to the completion of capital expenditure programs resulting in increased capacity. Pricing in Euro was comparable to the prior year; however, increased sales volumes partially offset by an approximate 7% depreciation in the Euro resulted in a net 4% increase in sales. Despite a weaker Euro, margins improved in the 2012 year as production efficiencies improved and waste rates declined. Included in shipments in 2012 were 3,171 tonnes (2011: 2,158 tonnes) of commissioned sales not produced at the Dresden mill ("Commissioned Sales").

Security Paper Products Segment

(thousands of dollars, except for shipments, unaudited)	**December 31, 2012**	**December 31, 2011**	**December 31, 2010**
Sales	57,066	54,206	73,203
Operating loss	(30,840)	(30,885)	(4,527)
Shipments (tonnes)	4,658	4,567	16,536

Similar to the prior year, the current year ended December 31, 2012 has been another difficult year. In June 2012, a significant banknote order was re-instated and production began part way through July 2012, improving operating efficiency but at a slower rate than anticipated. The operating loss included a net $1.3 million dispute resolution accrual to resolve a potential dispute with a customer.

An increase in security paper capacity at the Landqart mill from 2,500 tonnes to 10,000 tonnes became available in 2011 at a time where there was a general softening in the banknote industry, due in part to a delay in the re-design of the Euro and Swiss Franc banknotes, resulting in primarily smaller legacy orders being produced at the Landqart mill. Product mix, high raw material prices, pricing pressure, a strong Swiss currency, and less than optimal production efficiency on the mill's paper machines contributed to a disappointing and difficult year in 2011, and such the difficult market environment persisted in 2012.

Fortress Optical began operations in 2011 and generated sales of $1.0 million in the year ended December 31, 2012 and sales of $2.6 million in the year ended December 31, 2011.

Selected Cash Flow Items

(thousands of dollars, unaudited)

	Year Ended December 31, 2012	Year Ended December 31, 2011
Cash used before working capital changes	(14,002)	(6,623)
Non-cash working capital change	22,238	(16,109)
Cash provided (used by) operating activities	8,236	(22,732)
Cash provided from financing activities	102,250	154,832
Additions to property, plant and equipment	(132,863)	(162,161)
Other	31,686	9,020
Cash (used by) investing activities	(101,177)	(153,141)
Change in cash position	9,309	(21,041)
Foreign exchange (loss) gain on cash and cash equivalents	(715)	1,379

Fortress operates in a cyclical industry and its operating cash flows vary accordingly. Fortress' principal operating cash expenditures are for compensation and raw materials. Operating activities provided cash of $8.2 million and used cash of $22.7 million in the twelve months ended December 31, 2012 and 2011, respectively.

Working capital is subject to cyclical operating needs, the timing of collection of receivables and the payment of payables and expenses. The significant movement in 2012 is a result of decreased inventory and other receivables partially offset by lower payables attributable primarily to the completion of the Fortress Specialty Cellulose mill conversion project and the ongoing cogeneration project. In the prior year comparative period, operating activities used cash primarily as a result of increases in accounts receivable and inventory which were somewhat offset by increases in accounts payable.

Financing Activities

During the year, financing activities generated $102.3 million. In June 2012, Fortress completed the $25 million FSTQ Debenture financing as part of the financing initiatives related to the Fortress Global Cellulose mill conversion project. In July 2012, Fortress completed the 2012 Debenture Offering resulting in aggregate net proceeds of $65.5 million. Proceeds received from option exercises during the year were $0.6 million. Cash was generated by drawing on the final principal installments excluding holdbacks on the Company's loan agreement with IQ in respect of the Fortress Specialty Cellulose mill project. In March 2012, the Company entered into a new €25 million credit facility with Commerzbank AG. The new facility was used primarily to repay the balance of an existing loan agreement with GE Capital Bank AG (“GE”) that was used to finance the rebuild of papermachine no. 1 at the Landqart mill. A penalty fee of $2.6 million was paid in connection with the early repayment of the GE indebtedness. Payments on indebtedness and debt interest in 2012 used cash of $35.5 million and $13.6 million, respectively.

In the year ended December 31, 2011, financing activities generated $154.8 million. In February 2011, Fortress completed a public offering of common shares by way of short form prospectus resulting in aggregate net proceeds of $54.8 million. Proceeds received from option exercises throughout 2011 were $0.7 million. In December 2011, Fortress completed a public offering of 6.5% convertible unsecured subordinated debentures by way of short form prospectus resulting in aggregate net proceeds of $38.1 million. Also, in the twelve months ended December 31, 2011, proceeds of $74.1 million were received from additional debt, primarily through drawdowns under the loan agreement with IQ in respect of the conversion and cogeneration projects at the Fortress Specialty Cellulose mill. Payments on indebtedness and debt interest in 2011 used cash of $10.6 million and $2.3 million, respectively.

Investing Activities

Investing activities in the year ended December 31, 2012 and 2011 used cash of $101.2 million and $153.1 million, respectively. Investment activities relate primarily to the purchase of equipment and other capital expenditures at the mills. Cash used in investing activities for the year ended December 31, 2012 was positively impacted by the $19.4 million sale of non-core hydropower assets at Landqart as well as $14.5 million received from government programs and credits at the Fortress Specialty Cellulose mill. In the prior year, the Fortress Specialty Cellulose mill received $8.9 million from government programs.

Liquidity and Capital Resources

As at December 31, 2012, the Company has made aggregate expenditures of approximately $216.2 million, including $14.7 million in accounts payable, on the conversion of Fortress Specialty Cellulose mill to a dissolving pulp mill and the construction of a new cogeneration facility. As at the date of this MD&A, aggregate expenditures on the Fortress Specialty Cellulose mill project were approximately $224.8 million, including $11.7 million in accounts payable. In the latter part of the first quarter of 2012, management reassessed the cogeneration project and identified certain deficiencies in a previous estimate from an engineering firm as well as scope of work adjustments necessary in order to commence delivery of power early in 2013. Additional costs were incurred as a result of repairs required to the recovery boiler during the third quarter of 2012. Subsequent to the year end, the Company announced that commissioning and start-up activities relating to the cogeneration project at the Fortress Specialty Cellulose mill had incurred delays as a result of various factors, including unforeseen piping related delays, reduced manpower availability and minor scope of work adjustments. As a result of these and other previously reported issues, the current budgeted capital expenditures remaining to complete the Fortress Specialty Cellulose mill project as a whole, as at the date of this MD&A, are approximately $5.2 million in addition to the amounts in accounts payable. The Company expects delivery of power to commence early in the second quarter of 2013.

Although there can be no assurances, Fortress believes that current cash, cash generated from operations, tax credits, proceeds from the divestiture of non-core assets, proceeds from the 2012 Debenture Offering, together with amounts available under its existing or new credit facilities should be sufficient to meet its debt service, capital expenditure and short term working capital requirements. Fortress' future operating performance and its ability to finance capital expenditures, service its debt and pay other indebtedness of Fortress will be subject to future economic conditions, the financial success of Fortress' business, the successful ramp-up of its dissolving pulp production at the Fortress Specialty Cellulose Mill to full planned capacity combined with the cost benefits expected to be derived from the cogeneration facility once it is completed and other factors, some of which are not within Fortress' control, including but not limited to changes in market prices for its products, raw materials costs and foreign currency exchange rates. Although the ramp-up of dissolving pulp production to planned capacity at the Fortress Specialty Cellulose mill is anticipated to provide significant cash flow and liquidity, Fortress may determine, in its sole discretion, that market or financial conditions may warrant that it seek additional sources of capital on terms satisfactory to Fortress, including but not limited to additional debt or equity financing, in order to fund capital expenditures, provide additional working capital, enhance liquidity or for other general corporate purposes. See "Risks and Uncertainties".

At December 31, 2012, the Company had cash of $31.5 million and aggregate indebtedness of $255.9 million. Included in this indebtedness is $98.3 million drawn on the $102.4 million credit facility with IQ in respect of the Fortress Specialty Cellulose mill project. The remaining balance has been reported as "Other accounts receivable" since it represents an amount contractually owing to the Company by IQ under the credit facility, which provides that the Company is able to draw down on its loan after it confirms to IQ that certain qualifying capital expenditures have been made and fully paid. The amount that IQ is obligated to make available to the Company upon confirmation that such expenditures have been made meets the definition of an "asset" in accordance with the Conceptual Framework section of IFRS. A corresponding liability is also recorded under "Long term debt" in the balance sheet. There is no right of offset between these two amounts therefore both an asset and a liability have been recorded. Under this credit facility, the Company has, at its discretion, the right to defer a limited number of principal payments. The Company has exercised its right and elected to defer 2013 principal payments without penalty.

The Company has entered into a separate project financing loan with IQ of up to $132.4 million to fund the Fortress Global Cellulose mill conversion project (see “Significant Developments”). The Company has not yet drawn any amounts under this loan agreement. Subsequent to the end of the 2012 reporting period, the Company, through its subsidiary, Dresden Papier GmbH, entered into two new credit facilities in the aggregate amount of €15 million (approximately $20.25 million) with Commerzbank AG, which the Company expects will provide the Company with greater financial flexibility and enhanced working capital. See “Subsequent Event”.

Principal repayments of debt outstanding as at December 31, 2012 are required as follows:

	($ 000’s)
2013	7,761
2014	25,071
2015	24,238
2016	63,572
2017	45,048
Thereafter	111,475
	$277,165

Under existing credit facilities, the Company has deferred $13.0 million in 2013 planned principal payments without penalty.

Commitments

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

	($ 000’s)
2013	999
2014	176
2015	87
2016	67
2017	17
Thereafter	3
	$ 1,349

As at December 31, 2012 the Company has:

- committed to purchase $8.3 million in property, plant, and equipment,
- performance bonds in the amounts of €6.1 million; and
- committed to purchase steam from a supplier up to the end of 2015 for CHF0.9 million per year.

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

The Company monitors and assesses on an ongoing basis its financial performance in order to ensure that its net debt levels are prudent taking into account the anticipated direction of the business cycle. The Company monitors continuously 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 influenced materially by changes in the relative value of the Canadian dollar, Swiss Franc, US dollar and Euro.

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

(thousands of dollars)

	December 31, 2012	December 31, 2011
Cash and cash equivalents	31,491	22,897
Less total debt	255,901	152,408
Net debt	(224,410)	(129,511)
Shareholders' equity	229,330	231,639

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

The Company ensures it remains in compliance with all of its existing debt covenants in order to facilitate future access to capital. Management reviews past results and forecasts to monitor their compliance. The Company was in compliance with all externally imposed capital requirements for the years ended December 31, 2012 and 2011.

Outstanding Shares

The number of common shares outstanding at December 31, 2012 and the date of this report was 14,495,075 and 14,504,337, respectively. The number of options outstanding at December 31, 2012 and the date of this report was 690,725. At December 31, 2012 and the date of this report there were 201,202 and 264,440 restricted share units outstanding, respectively. At December 31, 2012 and the date of this report there were 149,670 and 157,212 deferred share units outstanding, respectively.

Related Party Transactions

Related party transactions consist of remuneration of directors and other key management personnel with whom we have entered in employment agreements. Further information is contained in our Management Information Circular dated June 7, 2012, which is available on SEDAR at www.sedar.com.

The remuneration of directors and other key management personnel was as follows:

	December 31, 2012 $	December 31, 2011 $
Salaries and other short-term employee benefits	3,187	4,667
Share-based awards	3,056	1,723
Total	6,243	6,390

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, amortization, asset recoverability, fair valuation of acquired assets, pensions and post-retirement obligations, provisions, stock compensation, income taxes and contingencies. Actual results could differ from these estimates.

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 its intended use. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probably that future economic benefits associated with the item will flow to the Company. The carrying amount of the replaced part is derecognized. Maintenance, repairs and minor replacements are expensed as incurred. The carrying amount of a replaced asset is derecognized when it is replaced.

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

The Company allocates the amount initially recognized in respect of an item of property, plant and equipment to its significant components and amortizes each such part separately. Residual values, methods of amortization and useful lives are reviewed at year end and adjusted if appropriate.

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. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or cash generating unit). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount and will be reviewed for possible reversal at each reporting date.

Employee Future Benefits

The Company maintains a defined contribution pension plan in Canada. The total cost recognized in 2012 for the Company's contribution to the plan was $1.3 million (2011: $1.1 million).

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, 2012. Actuarial valuations include certain assumptions that directly affect the fair value of the assets and obligations and expenses recorded in the financial statements. Actual experience can vary materially from the estimates and impact the cost of the Company's pension and future cash flow requirements. These assumptions and estimates include:

	December 31, 2012	December 31, 2011
Significant actuarial assumptions used are as follows	%	%
Discount rate to determine benefit obligations at end of year	2.1	2.5
Discount rate to determine benefit expense (income) for the year	2.5	2.9
Expected rate of return on plan assets	4.0	4.0
Rate of increase in future compensation	1.5	1.5
Future pension increases	0.0	0.0
Expected average remaining working lives in years	9.4	9.1
Plan assets at fair value at the end of the year	%	%
Liquid assets	2.5	9.0
Bonds	52.6	50.1
Equity — World	25.3	21.0
Real estate	19.6	19.9
	100.0	100.0

Deferred Taxes

In accordance with IFRS, Fortress recognizes deferred income tax assets when it is probable that the deferred income tax assets will be realized. This assumption is based on management's best estimate of future circumstances and events. If these estimates and assumptions are changed in the future, the value of the deferred income tax assets could be reduced or increased, resulting in an income tax expense or recovery. Fortress reevaluates its deferred income tax assets on a regular basis.

Provisions

Provisions for cleanup of landfill sites and legal claims, where applicable, are recognized as liabilities when the Company has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting year, and are discounted to present value where the effect is material.

Landfills / Environmental Remediation

The Company has costs associated with containment and ongoing maintenance relating to landfill sites in Canada. These costs are measured at fair value, which approximates the cost a third party would incur in performing the tasks associated with the landfill sites. These obligations represent estimated undiscounted future payments of $889 to remediate the landfills at the end of their useful lives. These payments are expected to occur within the next 12 months and have been recorded in accounts payable. Of the opening balance $nil was recorded as a provision and $853 was recorded in accounts payable at December 31, 2011.

On June 20, 2012, the Company purchased the assets of a mill in Lebel-sur-Quévillon, Québec. As part of the purchase, the Company entered into an environmental Trust Agreement (the "Environmental Trust") to be used for environmental remediation for potential problems that existed at the date of purchase. The Company does not have access to, and cannot control, the funds in the Trust. The Company must fund $7.5 million over the next 5 years in intervals. The Company must also fund another $2.5 million in the event that the mill is dismantled in the future. The liability for the Company is for existing environmental liabilities at the date of purchase has been limited at the amounts set out above. Any further environmental remediation costs are to be paid by the previous owners of the mill and the provincial government. The discount rates used for the valuation of the long-term liability range from 6.8% to 8.0% depending on the timing of the expected payment. The discount rate used for the valuation of the $2.5 million provision is 9.8%.

Contingencies

Provisions for liabilities relating to legal actions and claims require judgments using management's best estimates regarding projected outcomes and the range of loss, based on such factors as historical experiences and recommendations of legal counsel. Actual results may vary from estimates and the differences are recorded when known. In respect of a dispute which arose in the fourth quarter of 2011 relating to a faulty input which was provided by a third party supplier of the Landqart mill, the Company expects that any amounts under dispute will be reimbursed to the Company by the supplier. The net impact to the mill is therefore expected to be nil. The treatment of this dispute by the Company reflects the best estimate of management, however there is no assurance that all or any portion of the disputed amount will be reimbursed to the Company. A failure by the Company to be reimbursed for the cost of this input or to have the input replaced or repaired by the supplier could result in a material adverse impact on the financial results of Landqart.

Stock-based compensation

Included in stock-based compensation is an expense relating for stock options. During the year ended December 31, 2012, 300,000 options were granted to employees of the Company. The weighted average fair value of the options granted in 2012 was $6.80 per option at the grant date using the Black Scholes option pricing model. During the year ended December 31, 2011 there were no options granted. Option pricing models require the input of highly subjective assumptions including the expected volatility. Expected volatility is based on historical Fortress stock performance. 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:

	2012
Risk-free interest rate	1.4%
Expected life of options	5 years
Annualized volatility	52.3%
Dividend rate	Nil

Warrants

On June 20, 2012, the Company issued 715,000 warrants to a lender. The warrants have an exercise price of $21.52 and are exercisable from December 31, 2014 to December 31, 2017, when they expire. The warrants were valued at $8.62 per warrant at the grant date using the Black Scholes pricing model. The Black Scholes pricing model requires 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 warrants. Assumptions used in the pricing model are as follows:

	2012
Risk-free interest rate	1.3%
Expected life of warrants	5 years
Annualized volatility	51.2%
Dividend rate	Nil

New Accounting Pronouncements

The following accounting standards have been issued by the International Accounting Standards Board (“IASB”), and adopted for use in Canada by the Accounting Standards Board and are not expected to have a material impact on the amounts recorded in the financial statements of the Company.

- IFRS 10 – *Consolidated Financial Statements*;

- IFRS 11 – *Joint Arrangements*;
- IFRS 12 – *Disclosure of Interests in Other Entities*;
- IFRS 13 – *Fair Value Measurement*; and
- IAS 28 (revised) – *Investments in Associates and Joint Ventures*.

The Company has evaluated IAS 19 (revised) – *Employee Benefits*. The amendments to IAS 19 are effective for financial years beginning on or after January 1, 2013, with earlier adoption permitted. The amended Standard will result in an employee future benefit obligation of $1,773 and an expense of $1,543 for the 2012 comparative statements.

IAS 1 – *Presentation of Financial Statements,* which is effective for annual periods beginning on or after July 1, 2012, with earlier adoption permitted, is not expected to have a significant impact on amounts recorded in the financial statements of the Company but will change the presentation of the financial statements.

In 2011, the IASB also amended IFRS 9 – *Financial Instruments,* which is effective for annual periods beginning on or after January 1, 2015. The Company is still in the process of assessing the full impact of this standard.

Further details of the new or revised accounting standards and their potential impact on the Company can be found in the consolidated financial statements and notes as at and for the year ended December 31, 2012.

Risks and Uncertainties

A comprehensive discussion of risk factors is included in the Company's 2011 annual information form dated March 30, 2012, available on SEDAR at www.sedar.com. Those as well as the following additional risks may impact the business of the Company:

Fortress Global Cellulose Mill Project

The Company's plans to convert the Fortress Global Cellulose mill into a dissolving pulp operation and restart a cogeneration facility is subject to customary risks and uncertainties inherent for large capital projects which could result in the project not completing on schedule or as budgeted. Delays in receiving any operating permits or any required amendments to such permits could result in construction delays, operational deficiencies or funding shortfalls. The Fortress Global Cellulose mill could experience operating difficulties or delays during the period when production of dissolving pulp and, subsequently, "green" energy is being ramped up. The project may not achieve the Company's planned production, quality or cost projections in respect of the dissolving pulp operation, or the expected level of power generation from the cogeneration facility. Cost overruns, equipment breakdowns or failures to perform to design specifications, delays in the generation and sales of surplus energy, could have a material adverse effect on the Fortress Global Cellulose mill's results of operations and financial performance.

In addition, pursuant to the terms of the acquisition of the Fortress Global Cellulose mill, Fortress Global is limited to using the acquired assets to produce up to a maximum of 100,000 ADMT of market northern bleached softwood kraft ("NBSK") pulp at the mill and is restricted from producing paper grade pulp for a period of 10 years. These restrictions may represent a possible reduction in the re-sale value of the mill and a limitation on the ability to operate the mill as a NBSK or paper grade pulp producer.

Effects of Increased Indebtedness

The Company may incur additional indebtedness as amounts are drawn down from its project financing as the Fortress Global Cellulose mill project progresses. Increased debt levels may have important consequences for the Company, including, but not limited to the following:

- its ability to obtain additional financing to fund future operations or meet its working capital needs or any such financing may not be available on terms favorable to the Company or at all;
- a certain amount of the Company's operating cash flow will be dedicated to the payment of principal and interest on its indebtedness, thereby diminishing funds that would otherwise be available for its operations and for other purposes;
- a substantial decrease in net operating cash flows or an increase in the Company's expenses could make it more difficult for it to meet its debt service requirements, which could force the Company to modify its operations; and
- a leveraged capital structure which may place the Company at a competitive disadvantage by hindering its ability to adjust rapidly to changing market conditions or by making it vulnerable to a downturn in its business or the economy in general, as well as other risks associated with increased leverage.

The Company's ability to meet future debt service and other obligations may depend in significant part on the success of the Fortress Global Cellulose mill project and the Fortress Specialty Cellulose mill and the extent to which the Company can successfully implement its business and growth strategy. There can be no assurance that the Fortress Global Cellulose mill project or the Fortress Specialty Cellulose mill will be successful or that the Company will be able to implement its strategy fully or that the anticipated results of its strategy will be realized. The IQ project financing facility for the Fortress Global Cellulose mill is secured by a charge against all of the assets of Fortress Global. The Company has guaranteed the principal amount of the second tranche of the IQ loan.

Environmental Liabilities

Under the terms of the agreement to acquire the assets of the Fortress Global Cellulose mill, the Company assumed no responsibility for any existing environmental liabilities relating to the lands. However, Fortress Global is required to make contributions pursuant to a trust agreement of an aggregate of $7.5 million over the next five years and an additional contingent amount of $2.5 million in the event of a permanent closure of the Fortress Global Cellulose mill, in respect of environmental remediation costs. The failure by Fortress Global to make such contributions would result in defaults under the security agreements over its assets, which would have a material adverse effect on the continuation of the Fortress Global Cellulose mill project. Although the Company intends to operate the Fortress Global Cellulose mill in accordance with applicable environmental laws, there is no assurance that the Company will not incur additional costs and expenses relating to environmental matters in respect of the assets acquired or in the future as a result of its operations.

In connection with the sale by Landqart of its hydropower assets in May 2012, Landqart continues to be responsible for a period of 10 years for certain costs relating to historical environmental contamination. Although the Company believes that the Landqart mill has identified and provided for expenditures relating to known environmental matters, including the costs of environmental remediation, it is possible that the Company may incur significant costs in the future for any remediation during such 10 year period relating to the sold hydropower assets.

Forest and Timber Tenures

On April 1, 2010, the Québec Government proclaimed the Sustainable Forest Development Act (the "SFDA") which will officially replace the *Forest Act* (Québec) on April 1, 2013 and will significantly modify the current Québec Crown wood allocation regime. Pursuant to the SFDA, all previously granted timber supply and forest management agreements (commonly known as "CAAFs") under the *Forest Act* (Québec) will be cancelled and former CAAF holders will be entitled, under the new regime, to a timber supply guarantee, provided they meet certain conditions as set forth in the SFDA. The guaranteed annual volumes of timber under such guarantee will be determined by the Ministry of Natural Resources and Wildlife (Québec) ("MNRW") and the MNRW will have the discretion to reduce the volume to which a former CAAF holder was entitled under the previous regime. The percentage by which the volume will be reduced may vary among former CAAF holders depending on the species or groups of species concerned, the volumes of timber to which the former CAAF holder would have been entitled to on April 1, 2013 if the CAAF had not been cancelled and the regions from which the timber is sourced. This reduction of volumes of timber allocated to former CAAF holders will be made available to the "Timber Marketing Board", which will be given the responsibility to market the timber to eligible purchasers by way of public auction. Based on comfort letters received from the MNRW, the Company expects to receive a CAAF allocation in respect of the Forest Global Cellulose mill. Accordingly, any CAAF obtained by the Company at the Fortress Global Cellulose mill will be subject to risks and uncertainties relating to the new regime under the SFDA and, once a CAAF is obtained, there is no assurance that Fortress Global will be able to maintain its wood fibre supply allocation and the availability of, and price for, wood fibre provided for in such CAAF as of April 1, 2013. Although Fortress Global believes it can secure the necessary fibre required at the Fortress Global Cellulose mill, there is no assurance that it will be able to obtain any required fibre supply, by way of public auction or otherwise, in the event that timber volumes granted to it under a CAAF are reduced. An insufficient supply or increased cost or demand for wood fibre or raw materials could materially adversely affect the business, financial condition, results of operations and cash flows of the Fortress Global Cellulose mill.

Additional Funding Requirements

The Company may need additional financing in connection with its plan for converting the Fortress Global Cellulose mill and restarting a cogeneration facility thereat, which may not be available in a timely manner or on acceptable terms, if at all. The implementation of the Company's business plan at the Fortress Global Cellulose mill will require a substantial amount of capital and the amounts raised by the Company through the financing initiatives described herein, if completed, may not be sufficient to fund such business plan. The Company will accordingly have further capital requirements if it implements its business plan at the Fortress Global Cellulose mill or takes advantage of further opportunities for acquisitions.

Trade Restrictions/Dissolving Pulp Export Tariffs

In February 2013, MOFCOM announced that it would commence an anti-dumping investigation on the importing of cellulose pulp originating from the United States, Canada and Brazil, after receiving a petition from certain manufacturers in China. The period of investigation for dumping is from January 1, 2012 to December 31, 2012, and the period of investigation for industry injury is from January 1, 2010 to December 31, 2012. The announcement included Fortress Specialty Cellulose Ltd. (“Fortress Specialty”) as one of the Canadian producers that is subject to the investigation. Fortress Specialty registered with MOFCOM the same month and is in the process of preparing its response. The Company is unable to determine at this time whether such investigation is likely to result in the imposition of tariffs, however, if anti-dumping tariffs are imposed upon us in the future, we may experience reduced revenues and margins in any business that is subject to such tariffs or to the terms of any settlement of international dispute arising therefrom. These tariffs or settlement terms may have a material adverse effect on our business, financial results and financial condition.

Supply Risks

Suppliers to our mills have and may in the future require us to prepay in order to secure the supply of their products prior to delivery. If our mills are unable to make such prepayments, this may result in an inability to fulfill our supply arrangements and, further, suppliers may delay delivery of materials required in our production processes, which may result in delays in production and delivery of our orders. Although we anticipate being able to fulfill our orders substantially on time, any delays in the delivery of required materials from our suppliers may materially adversely impact our ability to timely fulfill our orders and our relationships with our customers, either of which may have a material adverse effect on our business, financial results and financial condition.

Financial Risk Management

The Company’s activities expose it to a variety of financial risks: credit risk, liquidity risk and market risk (including currency risk, fair value interest rate risk and cash flow interest rate risk).

(a) 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. Credit risk is managed on a Company basis, except for credit risk relating to accounts receivable balances. Each local entity is responsible for managing and analyzing the credit risk for each of their new clients before standard payment and delivery terms and conditions are offered. Credit risk arises from cash and cash equivalents, and deposits with banks and financial institutions, as well as credit exposures to customers.

Cash and cash equivalents include cash on deposit and cash equivalents 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, 2012 was $31.5 million (2011: $22.9 million).

The Company utilizes a combination of credit insurance and factoring to manage the risk associated with trade receivables. Approximately 59% of the outstanding trade receivables are covered under credit insurance or backed by letters of credit. The majority of the balance is with large and financially sound customers, including national banks. The Company sells all pulp through a third party agent that takes ownership of the inventory before it is delivered to the final customer. Accounts receivable aged greater than 90 days are $0.8 million of which $0.4 million is provided for as potentially impaired. The remaining amount is considered collectible. The Company's trade receivable balance at December 31, 2012 was $13.8 million (2011: $10.6 million).

Included in other accounts receivable is a $6.2 million receivable from a supplier related to a dispute where amounts have not been determined. It is management's best estimate that the amount will be collectible from the supplier and insurance; however, amounts collected could differ materially from what is recorded. If the dispute with the customer of the Company exceeds this amount, further reimbursement will be sought from the supplier.

(b) Liquidity Risk

Liquidity risk is the risk that the Company will be unable to meet its financial obligations as they become due. Cash flow forecasting is performed in the operating entities of the group in and aggregated by group finance. Group finance monitors rolling forecasts of the group's liquidity requirements to ensure it has sufficient cash to meet operational needs while not breaching borrowing limits or covenants. 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, 2012, the Company's accounts payable and accrued liabilities totaled $79.8 million (2011: $86.1 million), all of which fall due for payment within one year of the statement of financial position 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 equity and debt financings, 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 dissolving pulp, security and specialty papers and raw material costs. See "Liquidity and Capital Resources".

(c) 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.

(i) Interest rate risk:

The Company is exposed to interest rate risk through its financial assets and financial obligations bearing variable interest rates. 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.

(ii) Currency risk:

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

For the years ended December 31, 2012 and December 31, 2011, the Company did not use derivative instruments to reduce its exposure to currency risk for sales denominated in a foreign currency.

(d) Earnings Sensitivity

The Company has completed a sensitivity analysis to estimate the impact on operating earnings for the year that a change in foreign exchange rates or interest rates during the year ended December 31, 2012 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; and
- Changes in market interest rates 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 operating income	
Change of + 1% in CHF foreign exchange rate	-	$0.3 million
Change of + 1% in EUR foreign exchange rate	+	$0.7 million
Change of + 1% in USD foreign exchange rate	+	$1.0 million

The above results arise due to the combined impact of foreign currency fluctuations on operations and the translation of operations into the Company's functional currency. The currency risk is partially mitigated by both revenues and expenses being denominated in local currencies in Landqart and Dresden. Fortress will continue to monitor and evaluate the future use of exchange contracts to limit exposure to exchange fluctuations.

Changes in market interest rates would have no significant impact on operating income.

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.

Disclosure Controls and Internal Controls over Financial Reporting

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the board of directors of the Company and the Audit Committee. The Company's chief executive officer ("CEO") and chief financial officer ("CFO") have evaluated the effectiveness of these disclosure controls and procedures for the year ending December 31, 2012, and have concluded that they are effective.

The CEO and CFO 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, 2012 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, 2012, the CEO and CFO have concluded that these controls are operating effectively.

March 7, 2013

Independent Auditor's Report

To the Shareholders of
Fortress Paper Ltd.

We have audited the accompanying consolidated financial statements of Fortress Paper Ltd. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011 and the consolidated statements of operations, comprehensive income (loss), changes in equity and statements of cash flows for the years ended December 31, 2012 and December 31, 2011 and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

PricewaterhouseCoopers LLP
PricewaterhouseCoopers Place 250 Howe Street, Suite 700, Vancouver, British Columbia V6C 3S7
T: 604 806 7000 F: 604 806 7806 www.pwc.com/ca

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Fortress Paper Ltd. and its subsidiaries as at December 31, 2012 and December 31, 2011 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

(signed) PricewaterhouseCoopers LLP

Chartered Accountants

FORTRESS PAPER LTD.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Canadian dollars, amounts in thousands)

	Note	December 31, 2012 $	December 31, 2011 $
ASSETS			
Current			
Cash and cash equivalents		31,491	22,897
Restricted cash		2,600	553
Trade accounts receivable	5	13,835	10,619
Other accounts receivable	6	28,403	52,708
Inventories	7	53,064	62,151
Prepaid expenses	11	8,334	2,032
		137,727	150,960
Property, plant and equipment	8	440,227	340,349
Total assets		577,954	491,309
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities	9	79,806	86,114
Income taxes payable	10	3,123	2,224
Current portion of long-term debt	11	7,761	14,459
		90,690	102,797
Long-term debt	11	248,140	137,949
Deferred income taxes	10	2,086	12,466
Provisions and other long-term liabilities	12	5,528	–
Employee future benefits	13	2,180	6,458
Total liabilities		348,624	259,670
Shareholders' equity			
Share capital	14	178,052	175,200
Contributed surplus		26,078	13,010
Accumulated other comprehensive income		2,161	2,688
Retained earnings		23,039	40,741
Total shareholders' equity		229,330	231,639
Total liabilities and shareholders' equity		577,954	491,309
Commitments	19		
Subsequent event	24		

(See accompanying notes)

Approved by the Board of Directors:

“Chadwick Wasilenkoff” — Director

“Richard Whittall” — Director

FORTRESS PAPER LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS

For the years ended
(Canadian dollars, amounts in thousands)

	Note	December 31, 2012 $	December 31, 2011 $
Sales		314,439	308,913
Costs and expenses			
Cost of products sold		(284,836)	(268,238)
Amortization		(19,164)	(14,363)
Selling, general and administration		(36,291)	(37,375)
Stock-based compensation	15	(3,516)	(1,900)
Operating loss		(29,368)	(12,963)
Other income (expense)			
Finance expense	16	(15,314)	(4,016)
Finance income	16	355	293
Gain on sale of property, plant and equipment	8	19,297	–
Foreign exchange (loss) gain		(144)	1,395
Net loss before income taxes		(25,174)	(15,291)
Income tax recovery (expense)	10	4,287	(3,939)
Net loss for the year		(20,887)	(19,230)
Basic and diluted loss per share	17	$ (1.45)	$ (1.37)
Weighted average number of shares outstanding			
Basic and diluted	17	14,379,012	14,055,030

(See accompanying notes)

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

For the years ended
(Canadian dollars, amounts in thousands)

	Note	December 31, 2012 $	December 31, 2011 $
Net loss for the year		(20,887)	(19,230)
Other comprehensive loss			
Cumulative translation adjustment on foreign operations		(527)	779
Actuarial gain (loss) recognized on employee future benefits (net of taxes of ($638) and $1,455)	13	3,185	(7,227)
Asset limit on employee future benefits (net of taxes of $nil and ($1))	13	−	5
Total other comprehensive income (loss) for the year		2,658	(6,443)
Total comprehensive loss for the year		(18,229)	(25,673)

(See accompanying notes)

FORTRESS PAPER LTD.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

For the years ended
(Canadian dollars, amounts in thousands)

	Note	December 31, 2012 $	December 31, 2011 $
Share Capital	14		
Balance at beginning of period		175,200	111,148
Restricted share units vested		2,013	1,013
Exercise of stock options		839	974
Shares issued on redemption of convertible debt		–	7,283
Private placement		–	54,782
Balance at end of period		178,052	175,200
Contributed Surplus			
Balance at beginning of period		13,010	10,536
Stock based compensation	15	3,516	1,900
Restricted share units vested	15	(2,013)	(1,013)
Exercise of stock options	15	(231)	(269)
Shares issued on redemption of convertible debt		–	(948)
Issuance of convertible debt	11	7,388	2,804
Issuance of warrants	14	4,408	–
Balance at end of period		26,078	13,010
Retained Earnings			
Balance at beginning of period		40,741	67,193
Net loss for the period		(20,887)	(19,230)
Defined benefit plan actuarial gain (loss), net of tax		3,185	(7,222)
Balance at end of period		23,039	40,741
Accumulated Other Comprehensive Income			
Balance at beginning of period		2,688	1,909
Cumulative translation adjustment on foreign operations		(527)	779
Balance at end of period		2,161	2,688
Total equity		229,330	231,639

(See accompanying notes)

FORTRESS PAPER LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended
(Canadian dollars, amounts in thousands)

	Note	December 31, 2012 $	December 31, 2011 $
Cash flows from (used by) operating activities			
Net loss		(20,887)	(19,230)
Adjustments:			
Amortization		19,164	14,363
Income tax (recovery) expense	10	(4,287)	3,939
Income taxes paid		(7,855)	(9,441)
Foreign exchange loss (gain)		339	(992)
Finance expense		15,305	2,838
Gain on sale of assets	8	(19,297)	–
Stock-based compensation	15	3,516	1,900
		(14,002)	(6,623)
Change in non-cash working capital items			
Accounts receivable		2,780	(14,550)
Inventories		9,240	(21,186)
Prepaid expenses		(141)	(292)
Accounts payable and accrued liabilities and other		10,359	19,919
		8,236	(22,732)
Cash flows from (used by) financing activities			
Options exercised	15	608	705
Repayment of long-term debt	11	(35,492)	(10,381)
Proceeds from long-term debt	11	150,728	112,234
Net proceeds from issuance of common shares	14	–	54,782
Payment on capital leases		–	(202)
Payment of long-term debt interest		(13,594)	(2,306)
		102,250	154,832
Cash flows from (used by) investing activities			
Additions to property, plant and equipment		(132,863)	(162,161)
Sales of property, plant and equipment	8	19,413	–
Restricted cash		(2,270)	858
Proceeds from Green Transformation Program	18	1,000	8,912
Investment tax credits received	18	13,543	–
Acquisition of Fortress Optical Features		–	(750)
		(101,177)	(153,141)
Increase (decrease) in cash position		9,309	(21,041)
Foreign exchange (loss) gain on cash and cash equivalents		(715)	1,379
Cash and cash equivalents, beginning of year		22,897	42,559
Cash and cash equivalents, end of year		31,491	22,897
Supplementary cash flow information	25		

(See accompanying notes)

1. NATURE OF OPERATIONS

Fortress Paper Ltd. (the "Company" or "Fortress") was incorporated on May 30, 2006 under the laws of the Province of British Columbia. The address of the Company's registered office is 157 Chadwick Court – 2nd floor, North Vancouver, British Columbia, Canada V7M 3K2. From the date of incorporation to July 31, 2006, the Company was inactive. The Company's fiscal year-end is December 31. Fortress operates internationally in three distinct business segments: dissolving pulp, specialty papers and security paper products. The Company operates its dissolving pulp business at the Fortress Specialty Cellulose Mill located in Canada, which is also in the process of expanding into the renewable energy generation sector with the construction of a cogeneration facility. Fortress Specialty Cellulose was converted into a dissolving pulp mill with ramp up production starting in December of 2011. Commercial production at Fortress Specialty Cellulose for accounting purposes, with the equipment operating as intended by management, began on March 18, 2012. Prior to commercial production of dissolving pulp, results from dissolving pulp start-up operations were capitalized to property, plant, and equipment. The Company is also seeking to expand its dissolving pulp capacity with the recent acquisition of the Fortress Global Cellulose Mill located at Lebel-sur-Quévillon, Québec, which the Company intends to convert into a dissolving pulp mill and re-start the cogeneration facility. The Company operates its specialty papers business at the Dresden Mill located in Germany, where it is a leading international producer of specialty non-woven wallpaper base products. The Company operates its security paper products business at the Landqart Mill located in Switzerland, where it produces banknote, passport, visa and other brand protection and security papers, and at its Fortress Optical Facility located in Canada, where it manufacturers optically variable thin film material.

2. BASIS OF PRESENTATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of financial statements as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). The Company has consistently applied the same accounting policies throughout all years presented.

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as of December 31, 2012. The consolidated financial statements were authorized for issue by the Board of Directors of the Company on March 7, 2013.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 3.

The consolidated financial statements have been prepared on the historical cost basis with the exception of compound financial instruments, employee future benefits, and provisions which are discussed in Note 3.

3. 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.

Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each consolidated entity are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

The financial statements of entities that have a functional currency other than Canadian dollars ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities – at the closing rate at the date of the statement of financial position, and income and expenses – using actual rates in place at the time or an average rate if it is considered a reasonable approximation. All resulting changes are recognized in other comprehensive income as cumulative translation adjustments.

When an entity disposes of its entire interest in a foreign operation, or loses control, joint control, or significant influence over a foreign operation, the foreign currency gains or losses accumulated in other comprehensive income related to the foreign operation are recognized in profit or loss. If an entity disposes of part of an interest in a foreign operation which remains a subsidiary, a proportionate amount of foreign currency gains or losses accumulated in other comprehensive income related to the subsidiary are reallocated between controlling and non-controlling interests.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in currencies other than an operation's functional currency are recognized in the statement of operations.

Consolidation

Subsidiaries are all entities (including special purpose entities) over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights.

Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are de-consolidated from the date that control ceases.

The Company applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Company. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

Acquisition-related costs are expensed as incurred.

Inter-Company transactions, balances, income and expenses on transactions between Company companies are eliminated. Profits and losses resulting from inter-Company transactions that are recognised in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

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 equivalents.

Trade accounts receivable

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment.

Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

(i) Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short term. Derivatives are also included in this category unless they are designated as hedges. The Company does not hold any instruments in this category.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statement of operations. Gains and losses arising from changes in fair value are presented in the statement of operations within other gains and losses in the year in which they arise.

Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond 12 months of the statement of financial position date, which is classified as non-current.

(ii) Available-for-sale investments: Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company does not hold any instruments in this category.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive income. Available-for-sale investments are classified as non-current, unless the investment matures within 12 months, or management expects to dispose of them within 12 months.

Interest on available-for-sale investments, calculated using the effective interest method, is recognized in the statement of operations as part of interest income. Dividends on available-for-sale equity instruments are recognized in the statement of operations as part of other gains and losses when the Company's right to receive payment is established. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of operations and included in other gains and losses.

(iii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise trade accounts receivable, other accounts receivable, and cash and cash equivalents, and are included in current assets due to their short-term nature. The Company also classifies restricted cash as loans and receivables, which is classified as a non-current asset. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

The Company transfers trade receivables under certain financial institution sponsored revolving securitization programs. Because the Company transfers substantially all the risks and rewards of ownership of the factored receivables, it derecognizes the carrying amount of these receivables as the cash is received.

(iv) Financial liabilities at amortized cost: Financial liabilities at amortized cost include trade payables and long-term debt. Trade payables are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method. Long-term debt is recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within 12 months. Otherwise, they are presented as non-current liabilities.

(v) Derivative financial instruments: The Company does not hold any derivative financial instruments or have any embedded derivative financial instruments which are not closely related to the host contract.

Government assistance

Government assistance relating to the acquisition of property, plant and equipment is recorded as a reduction of the cost of the asset to which it relates, with any amortization calculated on the net amount. Government assistance related to non-capital projects is recorded as a reduction of the related expenses.

Inventories

Inventories are valued at the lower of average cost and net realizable value. The cost of finished goods and work-in-progress comprises raw materials, direct labour, other direct costs and related production overheads including applicable amortization on property, plant and equipment. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expenses.

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 its intended use. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probably that future economic benefits associated with the item will flow to the Company. The carrying amount of the replaced part is derecognized. Maintenance, repairs and minor replacements are expensed as incurred. The carrying amount of a replaced asset is derecognized when it is replaced.

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

The Company allocates the amount initially recognized in respect of an item of property, plant and equipment to its significant components and amortizes each such part separately. Residual values, methods of amortization and useful lives are reviewed at year end and adjusted if appropriate.

Long-term debt

Long-term debt is recognized initially at fair value, net of transaction costs incurred. Long-term debt is subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statement of operations over the term of the borrowings using the effective interest method.

Fees paid on the establishment of loan facilities are recognized as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw-down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalized as a pre-payment for liquidity services and amortized over the term of the facility to which it relates.

Long-term debt is classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting year.

Trade accounts payable

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

Compound financial instruments

Compound financial instruments issued by the Company comprise convertible notes that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition except on conversion or expiry.

Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of new common shares or options are shown in equity as a deduction, net of tax, from the proceeds.

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. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or cash generating unit). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount and will be reviewed for possible reversal at each reporting date.

Borrowing costs

Borrowing costs attributable to the acquisition, construction or production of qualifying assets are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognized as interest expense in the statement of operations in the year in which they are incurred.

Employee future benefits

Employees of companies included in these consolidated financial statements have entitlements under Company pension plans which are either defined contribution or defined benefit pension plans. These plans take different forms depending on the legal regime of each country.

For the Company's defined contribution pension plan, contributions are recognized as employee benefit expense when they are due.

For the Company's defined benefit pension plan the following policies have been adopted:

- The measurement date used for accounting purposes is December 31;
- The cost of pensions earned by employees is actuarially determined using the projected unit credit method pro-rated on service and management's estimate of expected plan investment performance, salary escalation and retirement ages of employees;
- The discount rate applied in arriving at the present value of the pension liability represents yields on high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the pension liability;
- For the purpose of calculating the expected return on plan assets, those assets are valued at fair value;
- The related net pension liability recognized in the statement of financial position is the fair value of the plan assets less the present value of the defined benefit obligation at the statement of financial position date; and
- Actuarial gains and losses are recognized during the year in which they occur, in other comprehensive income (loss) and retained earnings, without recycling to the statement of operations in subsequent years.

Income taxes

Income taxes comprise current and deferred taxes. Income tax is recognized in the statement of operations except to the extent that it relates to items recognized directly in other comprehensive income (loss) or equity, in which case the income tax is recognized directly in other comprehensive income (loss) or equity, respectively.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted, or substantively enacted, at the end of the reporting year in the countries where the Company and its subsidiaries operate and generate taxable income. The Company periodically evaluates the position taken and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred tax is recognized, using the liability method, in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the statement of financial position date and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered.

Deferred income tax is provided for taxable temporary differences associated with investments in subsidiaries except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

Deferred income tax assets and liabilities are presented as non-current and are offset when there is a legally enforceable right to offset tax assets against tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Earnings (loss) per share

Basic earnings (loss) per share are computed using the weighted average number of common shares outstanding during the year. 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. Diluted earnings per share for convertible debt assumes the debt has been converted at the beginning of the period or, if later, the date of the issue of the convertible debt.

Stock-based compensation

The Company grants stock options and other share-based awards to certain employees. Each tranche in an award is considered a separate award with its own vesting year and grant date fair value. The fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. 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.

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 products sold. The Company does not have any multiple element revenue arrangements.

Development costs

Expenditure incurred in the development of products or enhancements to existing product ranges is capitalized as an intangible asset only when the future economic benefits expected to arise are deemed probable and the costs can be reliably measured. Development costs not meeting these criteria are expensed in the statement of operations as incurred. Capitalized development costs are amortized on a straight-line basis over their estimated useful economic lives once the product or enhancement is available for use. Product research costs are written off as incurred.

Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of operations on a straight-line basis over the year of the lease.

The Company leases certain property, plant and equipment. Leases of property, plant and equipment where the Company has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments.

Each lease payment is allocated between the liability and finance charges. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of the finance cost is charged to the statement of operations over the lease year so as to produce a constant periodic rate of interest on the remaining balance of the liability for each year. The property, plant and equipment acquired under finance leases are amortized over the shorter of the useful life of the asset and the lease term.

Estimates

The preparation of financial statements and related disclosures in conformity with IFRS 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 provision for doubtful accounts, amortization, asset recoverability, fair valuation of acquired assets, pensions and post-retirement obligations, provisions, stock compensation, income taxes and contingencies. Actual results could differ from these estimates.

Segmented reporting

Operating segments are reported in a manner consistent with the internal reporting provided to management and the Board of Directors. The Company's operations are managed and reported internally on a divisional basis that reflects the different characteristics of each business. These divisions have been disclosed as reportable segments because they are the components that the Board monitors regularly in making decisions about operating matters such as allocating resources to businesses and assessing performance.

Provisions

Provisions for cleanup of landfill sites and legal claims, where applicable, are recognized as liabilities when the Company has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting year, and are discounted to present value where the effect is material.

4. NEW ACCOUNTING PRONOUNCEMENTS

The following IFRS have been issued by the IASB, and adopted for use in Canada by the Accounting Standards Board:

IFRS 9 - Financial Instruments

In November 2009, the IASB issued IFRS 9, Financial Instruments. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in International Accounting Standard ("IAS") 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments with recognition at fair value through profit or loss or at fair value through other comprehensive earnings.

IFRS 9 is effective for annual years beginning on or after January 1, 2015. The Company is currently assessing the impact of this standard on the financial statements.

IFRS 10 - Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10, Consolidated Financial Statements. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. This IFRS defines the principle of control and establishes control as the basis for determining which entities are consolidated in an entity's consolidated financial statements. IFRS 10 sets out three elements of control: a) power over the investee; b) exposure, or rights, to variable returns from involvement with the investee; and c) the ability to use power over the investee to affect the amount of the investor's return. IFRS 10 sets out the requirements on how to apply the control principle. IFRS 10 and IFRS 12 supersede IAS 27, Consolidated and Separate Financial Statements and SIC-12, Consolidation – Special Purpose Entities.

This standard is effective for annual years beginning on or after January 1, 2013, with earlier application permitted if adopted along with IFRS 11, IFRS 12, IAS 27 (revised) and IAS 28 (revised). The adoption of this standard is not expected to have a significant impact on the Company.

IFRS 11 – Joint Arrangements

In May 2011, the IASB issued IFRS 11, Joint Arrangements, which provides guidance on accounting for joint arrangements. If an arrangement has joint control, IFRS 11 classifies joint arrangements as either joint operations or joint ventures, depending on the rights and obligations of the parties involved.

A joint operation is an arrangement where the jointly controlling parties have rights to the assets and obligations in respect of the liabilities relating to the arrangement. An entity accounts for a joint operation by recognizing its portion of the assets, liabilities, revenues and expenses. A joint venture is an arrangement where the jointly controlling parties have rights to the net assets of the arrangement. A joint venture is accounted for using the equity method. Proportionate consolidation is no longer permitted.

This standard is effective for annual years beginning on or after January 1, 2013, with early adoption permitted. This standard is not expected to have a significant impact on the financial statements as Fortress currently has no joint arrangements.

IFRS 12 – Disclosure of Interests in Other Entities

In May 2011, the IASB issued IFRS 12, Disclosure of Interests in Other Entities. IFRS 12 outlines the disclosure requirements for interests in subsidiaries and other entities to enable users to evaluate the risks associated with interests in other entities and the effects of those interests on an entity's financial position, financial performance and cash flows. IFRS 10 and IFRS 12 supersede IAS 27, Consolidated and Separate Financial Statements and SIC-12, Consolidation – Special Purpose Entities.

This standard is effective for annual years beginning on or after January 1, 2013, with early adoption permitted. This standard is not expected to have a significant impact on the financial statements of the Company.

IFRS 13 – Fair Value Measurement

In May 2011, the IASB issued IFRS 13, Fair Value Measurement. This standard defines fair value, sets out a single IFRS framework for measuring fair value and outlines disclosure requirements about fair value measurements. IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is a market-based measurement, not an entity-specific measurement, so assumptions that market participants would use should be applied in measuring fair value.

This standard is effective for annual years on or after January 1, 2013, with earlier application permitted. This IFRS is to be applied prospectively as of the beginning of the annual year in which it is initially applied and the disclosure requirements do not need to be applied in comparative years before initial application. This standard is not expected to have a significant impact on amounts recorded in the financial statements of the Company.

IAS 1 – Presentation of Financial Statements

IAS 1 has been amended to require entities to separate items presented in other comprehensive income ("OCI") into two groups, based on whether or not items may be recycled to net income in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. The amendment is effective for annual years beginning on or after July 1, 2012, with earlier application permitted. IAS 1 is not expected to have a significant impact on amounts recorded in the financial statements of the Company but will change the presentation of the financial statements.

IAS 19 – Employee Benefits

In June 2011, the IASB issued an amended version of IAS 19, Employee Benefits. The amendments to IAS 19 are meant to improve the quality, transparency and comparability of information presented for post-employment benefits. For defined benefit plans, the amendments eliminate the option to defer actuarial gains and losses on the statement of financial position through the "corridor method". The amendments also require any remeasurement gains or losses, including actuarial gains and losses, to be recognized immediately and presented in OCI, eliminating the option to recognize and present these through the income statement. Additional disclosures will also be required to present better information about the characteristics, amounts recognized, and risks related to defined benefit plans.

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

The amendments to IAS 19 are effective for financial years beginning on or after January 1, 2013, with earlier adoption permitted. The amended Standard will result in an employee future benefit obligation of $1,773 and an expense of $1,543 for the 2012 comparative statements.

5. TRADE ACCOUNTS RECEIVABLE

	Note	December 31, 2012 $	December 31, 2011 $
Trade accounts receivable		14,251	15,072
Less: provision for impairment of trade receivable	23	(416)	(4,453)
Trade accounts receivable		13,835	10,619

6. OTHER ACCOUNTS RECEIVABLE

	Note	December 31, 2012 $	December 31, 2011 $
Receivable from lender	11	4,052	8,092
Investment and other tax credits		468	14,088
Value added tax		6,668	10,990
Holdbacks receivable		6,690	7,388
Receivable from supplier	12	6,241	6,229
Government grant	18	1,194	2,713
Other		3,090	3,208
		28,403	52,708

7. INVENTORIES

	December 31, 2012 $	December 31, 2011 $
Raw materials	37,475	51,851
Work in progress	1,987	1,851
Finished goods	13,602	8,449
	53,064	62,151

The cost of raw materials, purchased materials and change in inventory recognized as expenses included in cost of products sold amounted to $190,968 (2011: $162,009).

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

The carrying amount of inventories pledged as security amounted to $16,309 (2011: $43,530).

8. PROPERTY, PLANT AND EQUIPMENT

	2012				
	Land	Building	Equipment	Work in Progress	Total
	$	$	$	$	$
At December 31, 2011					
Cost	23,080	53,839	148,128	147,653	372,700
Accumulated amortization	–	(4,153)	(28,198)	–	(32,351)
Net book value	23,080	49,686	119,930	147,653	340,349
Year ended December 31, 2012					
Purchase of Fortress Global Cellulose	–	–	7,206	–	7,206
Additions	–	311	333	111,416	112,060
Disposals	(86)	–	(71)	–	(157)
Transfers	–	36,973	95,959	(132,932)	–
Amortization for the year	–	(2,958)	(16,206)	–	(19,164)
Exchange differences	(4)	4	(32)	(35)	(67)
Net book value	22,990	84,016	207,119	126,102	440,227
At December 31, 2012					
Cost	22,990	91,157	251,556	126,102	491,806
Accumulated amortization	–	(7,141)	(44,437)	–	(51,578)
Net book value	22,990	84,016	207,119	126,102	440,227

	2011				
	Land	Building	Equipment	Work in Progress	Total
	$	$	$	$	$
At December 31, 2010					
Cost	22,796	35,744	80,716	66,532	205,788
Accumulated amortization	–	(1,783)	(17,231)	–	(19,014)
Net book value	22,796	33,961	63,485	66,532	186,774
Year ended December 31, 2011					
Purchase of Fortress Optical	–	–	624	–	624
Additions	–	2,546	19,695	143,398	165,639
Transfers	–	15,256	46,386	(61,642)	–
Amortization for the year	–	(2,382)	(11,981)	–	(14,363)
Exchange differences	284	305	1,721	(635)	1,675
Net book value	23,080	49,686	119,930	147,653	340,349

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

At December 31, 2011					
Cost	23,080	53,839	148,128	147,653	372,700
Accumulated amortization	–	(4,153)	(28,198)	–	(32,351)
Net book value	23,080	49,686	119,930	147,653	340,349

Work in progress at December 31, 2012 mainly comprises of equipment under construction for the cogeneration project at the Fortress Specialty Cellulose mill. Work in progress at December 31, 2011 mainly comprises of equipment under construction for the conversion of the Fortress Specialty Cellulose mill to produce dissolving pulp and for the cogeneration project at the Fortress Specialty Cellulose mill.

Included in property, plant and equipment were capitalized borrowing costs and accretion of $3,105 (2011: $1,409). Borrowing costs and accretion were capitalized at effective interest rates ranging from 4.1% to 5.6%.

Property, plant and equipment pledged as security for loans and mortgages amounted to $330,312 (2011: $307,681).

On June 20, 2012, the Company purchased the assets of a shutdown pulp mill in Lebel-sur-Quévillon, Québec through a wholly owned subsidiary, Fortress Global Cellulose. The Company will be converting the mill into a dissolving pulp mill. The mill was not in operation during 2012. The purchase price of $7,205 was recorded to property, plant and equipment and was made up of the following:

	Note	**$**
Purchase price		–
Transaction costs		1,394
Asset retirement obligation assumed	12	5,811
		7,205

During the year ended December 31, 2012, the Company sold its hydropower assets and associated real estate at the Landqart mill for CHF 18 million. The carrying amount of the assets sold was CHF 104.

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	Note	**December 31, 2012 $**	**December 31, 2011 $**
Trade payables		55,465	60,547
Project accruals		2,352	7,010
Employee accruals		6,317	6,727
Customer prepayments		5,293	2,655
Inventory purchase accruals		1,082	1,780
Landfill and environmental remediation	12	1,389	853
Other accruals		7,908	6,542
		79,806	86,114

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

10. INCOME TAXES

The analysis of deferred tax assets and deferred tax liabilities is as follows:

	December 31, 2012 $	December 31, 2011 $
Deferred tax assets:		
Deferred tax asset to be reversed after more than 12 months	35,446	11,285
Deferred tax asset to be reversed within 12 months	–	–
	35,446	11,285
Deferred tax liabilities:		
Deferred tax liability to be recovered after more than 12 months	34,838	22,589
Deferred tax liability to be recovered within 12 months	2,694	1,162
	37,532	23,751
Deferred tax liability (net)	2,086	12,466

The gross movement on the deferred income tax account is as follows:

	December 31, 2012 $	December 31, 2011 $
Opening deferred tax liability (net)	12,466	18,526
Charged to operations	(13,382)	(4,162)
Charged to comprehensive income	638	(1,455)
Charged to property, plant and equipment	(3,060)	(2,222)
Charged directly to equity	5,448	1,661
Exchange differences	(24)	118
Deferred tax liability (net)	2,086	12,466

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

The movement in deferred income tax assets and liabilities during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

Deferred Tax Liabilities	Employee Future Benefits $	Property, Plant and Equipment $	Long-term Debt $	Other $	Total $
As at December 31, 2010	278	18,248	–	–	18,526
Charged to operations	–	3,473	(7)	356	3,822
Charged to comprehensive income	(278)	–	–	–	(278)
Charged directly to equity	–	–	1,661	–	1,661
Exchange differences	–	23	–	(3)	20
As at December 31, 2011	–	21,744	1,654	353	23,751
As at December 31, 2011	–	21,744	1,654	353	23,751
Charged to operations	–	8,657	(454)	137	8,340
Charged directly to equity	–	–	5,448	–	5,448
Exchange differences	–	(7)	–	–	(7)
As at December 31, 2012	–	30,394	6,648	490	37,532

Deferred Tax Assets	Tax Credits $	Tax Loss Carry-forwards $	Employee Future Benefits $	Other $	Total $
As at December 31, 2010	–	–	–	–	–
Charged to operations	–	7,801	(6)	189	7,984
Charged to comprehensive income	–	–	1,176	–	1,176
Charged to property, plant and equipment	2,222	–	–	–	2,222
Exchange differences	–	–	(93)	(4)	(97)
As at December 31, 2011	2,222	7,801	1,077	185	11,285
As at December 31, 2011	2,222	7,801	1,077	185	11,285
Charged to operations	730	18,254	(93)	2,831	21,722
Charged to comprehensive income	–	–	(638)	–	(638)
Charged to property, plant and equipment	3,060	–	–	–	3,060
Exchange differences	–	–	17	–	17
As at December 31, 2012	6,012	26,055	363	3,016	35,446

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

Deferred income tax assets are recognized for tax loss carry-forwards and other tax credits to the extent that the realization of the related tax benefit through future taxable profits is probable. The Company did not recognize deferred tax assets of $10,864 in 2012. Tax loss carry-forwards consist of approximately $49,317 from the Security operations, which expire beginning in 2015 through 2032, and $17,665 from Corporate, which expire beginning in 2026 through 2032.

The components of income tax (recovery) expense are as follows:

	Year Ended December 31, 2012 $	Year Ended December 31, 2011 $
Current	9,095	8,101
Deferred	(13,382)	(4,162)
	(4,287)	3,939

The reconciliation of income taxes calculated at the statutory rate of 25.0% to the actual income tax provision is as follows:

	Year Ended December 31, 2012 $	Year Ended December 31, 2011 $
Net loss before income taxes	(25,174)	(15,291)
Income tax recovery at statutory rates	(6,293)	(4,051)
Stock-based compensation and other non-deductible expenses	872	(170)
Rate differentials between foreign jurisdictions, capital gains and future tax rates	4,485	3,256
Investment and other tax credits	(730)	–
Tax loss carry-forward expired	–	202
Change in deferred tax assets not recognized	(2,621)	4,702
Income tax (recovery) expense	(4,287)	3,939

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

11. LONG-TERM DEBT

	December 31, 2012 $	December 31, 2011 $
Credit agreement with bank maturing 2013; interest at 2.7%; secured by current assets (EUR 96; 2011: EUR 289)	126	381
Credit agreement with lender maturing 2018; interest at 6.2% and 7.1%; secured by property, plant and equipment (EUR nil; 2011: EUR 19,675) (a)	–	25,958
Credit agreement with lender maturing 2017; interest at 3.8% secured by property, plant and equipment and inventory (EUR 22,339; 2011: EUR nil) (b)	29,305	–
Credit agreement with bank maturing 2012; interest at 4.8%; unsecured (CHF nil; 2011: CHF 1,570)	–	1,703
Credit agreement with bank maturing 2015; interest at 4.9%; secured by property, plant and equipment (CHF 2,250; 2011: CHF 5,400)	2,445	5,857
Credit agreement with lender maturing 2020; unsecured (CHF 4,461; 2011: CHF 4,584) (c)	4,849	4,972
Credit agreement with lender maturing 2016; interest at 6.5%; unsecured (d)	34,695	33,636
Credit agreement with lender maturing 2020; interest up to 5.5%; secured by assets (e)	104,523	79,901
Credit agreement with lender maturing 2017; interest at 7%; unsecured (f)	22,548	–
Credit agreement with lender maturing 2019; interest at 7%; unsecured (g)	57,410	–
Credit agreement with lender maturing 2023; interest up to 5.5%; secured by assets (h)	–	–
	255,901	152,408
Less: Current portion	(7,761)	(14,459)
Long-term debt	248,140	137,949

	December 31, 2012 $	December 31, 2011 $
Principal value of debt	277,165	160,819
Unamortized borrowing costs and amounts allocated to equity	(21,264)	(8,411)
Net amount recorded in liabilities	255,901	152,408

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

Principal repayments as at December 31, 2012 are required as follows:

	$
2013	7,761
2014	25,071
2015	24,238
2016	63,572
2017	45,048
Thereafter	111,475
	277,165

Borrowings under the above agreements require maintenance of certain financial and non-financial covenants. The Company has been in compliance with all covenants for the year ended December 31, 2012.

(a) At March 30, 2012, the remaining EUR 19,296 of the facility was repaid in full, utilizing proceeds from (b) below. A prepayment penalty of EUR 1,992 has been recorded in finance expenses. Up to the date of repayment, the facility had an interest rate of 7.1%. Interest was calculated at a 7.6% effective rate.

(b) The credit agreement is a facility for up to EUR 25,000, of which EUR 25,000 has been drawn as at December 31, 2012. The facility bears interest at a rate of 3.8%. Beginning in September 2012, the loan is repayable in equal quarterly installments over 5 years. Interest has been calculated at a 4.1% effective rate.

(c) The credit agreement is a facility for CHF 5,310 that bears no interest and is repayable based on the timing of production for the lender. Interest has been calculated at a 5% effective rate.

(d) The credit agreement is an unsecured convertible note of the Company in the principal amount of $40,250 that matures in December 2016. The convertible note bears interest at an annual rate equal to 6.5%, calculated semi-annually.

The holder of the convertible note may, at its option, convert the convertible note into common shares at any time prior to maturity. The conversion price shall be equal to $37.50 per share.

The Company may redeem the debentures in whole or in part on and after December 31, 2014 and prior to the maturity date, at its option, and repay in advance the debenture at a price equal to the principal amount plus accrued and unpaid interest, provided that the volume weighted average trading price of common shares on the Toronto Stock Exchange during 20 consecutive trading days is not less than $46.88 per share.

After considering borrowing costs of $2,178, the Company initially recorded a liability portion of $33,607 and an equity portion of $2,804 in contributed surplus (net of ($1,661) tax). The liability portion was valued using a 9.5% initial interest rate. Interest is calculated at a 10.9% effective rate.

(e) The credit agreement is a facility for up to $102.4 million, granted to Fortress Specialty Cellulose to support the conversion to dissolving pulp and co-generation capital expenditure programs. At December 31, 2012, $102,400 (December 31, 2011, $79,502) has been drawn on this facility. Of this amount $4,052 is pending receipt from the lender and has been included in other accounts receivable (December 31, 2011: $8,092). The facility bears interest at a rate of 5% for the first five years of the loan and at a rate of up to 5.5% for the second five years of the loan.

Commencing after two years, the facility is repayable in equal quarterly installments up to June 30, 2020. Interest for the first two years of the credit agreement is added to the principal of the loan. The total interest capitalized and added to the principal up to December 31, 2012 is $2,236.

Interest has been calculated at a 5.6% effective rate.

(f) The credit agreement is an unsecured convertible note of the Company in the principal amount of $25,000 that matures in June 2017. The convertible note bears interest at an annual rate equal to 7%, calculated semi-annually.

Commencing June 20, 2012, the holder of the convertible note may, at its option, convert the convertible note into common shares at any time until the close of business on the last business day prior to maturity. The conversion price shall be equal to $32.28 per share.

The Company may redeem the convertible note on or after June 20, 2014, at its option and repay in advance this option in whole or in part at par plus accrued and unpaid interest if the volume weighted average trading price of common shares on the TSX during 20 consecutive trading days, is not less than $40.35 per share.

After considering borrowing costs of $211, the Company initially recorded a liability portion of $22,328 and an equity portion of $1,793 in contributed surplus (net of ($668) tax). The liability portion was valued using a 9.5% initial interest rate. Interest is calculated at a 9.7% effective rate.

(g) The credit agreement is an unsecured convertible note of the Company in the principal amount of $69,000 that matures in December 2019. The convertible note bears interest at an annual rate equal to 7%, calculated semi-annually.

The holder of the convertible note may, at its option, convert the convertible note into common shares at any time prior to maturity. The conversion price shall be equal to $31.00 per share.

The Company may redeem the debentures in whole or in part on and after July 1, 2015 and prior to July 1, 2017, at its option, and repay in advance the debenture at a price equal to the principal amount plus accrued and unpaid interest, provided that the volume weighted average trading price of common shares on the Toronto Stock Exchange during 20 consecutive trading days is not less than $38.75 per share. On or after July 1, 2017 and prior to the maturity date, the debentures may be redeemed in whole or in part at the option of the Company at a price equal to the principal amount plus accrued and unpaid interest.

After considering borrowing costs of $3,491, the Company initially recorded a liability portion of $56,855 and an equity portion of $5,594 in contributed surplus (net of ($3,029) tax). The liability portion was valued using a 9.5% initial interest rate. Interest is calculated at a 10.4% effective rate.

(h) The credit agreement is a facility for up to $132.4 million, granted to Fortress Global Cellulose to support the conversion to dissolving pulp expenditure program. The loan is repayable ten years after the first draw on the facility. At December 31, 2012, $nil has been drawn on this facility. The facility bears interest at a rate of 5% for the first five years of the loan and at a rate of up to 5.5% for the second five years of the loan. Commencing two years after the first draw on the loan, the facility is repayable in equal quarterly installments. Interest for the first two years of the credit agreement is added to the principal of the loan.

Borrowing costs of $7,006 have been deferred and recorded as a prepaid expense until the loan is drawn upon.

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

Included in the borrowing costs of the loan are 715,000 warrants which have been provided to the lender. The warrants have an exercise price of $21.52 and are exercisable from December 31, 2014 to December 31, 2017, when they expire *(note 14)*.

Interest will be calculated at a 6.3% effective rate.

12. PROVISIONS AND OTHER LONG-TERM LIABILITIES

	December 31, 2012 $	December 31, 2011 $
Provisions		
Landfills	889	853
Customer provisions	–	–
Environmental remediation	143	–
	1,032	853
Long term liabilities		
Environmental remediation	5,885	–
	6,917	853
Less: current portion of provisions and long-term liabilities	(1,389)	(853)
Total provisions and other long-term liabilities	5,528	–

Landfills

The Company has costs associated with containment and ongoing maintenance relating to landfill sites in Canada. These costs are measured at fair value, which approximates the cost a third party would incur in performing the tasks associated with the landfill sites. These obligations represent estimated undiscounted future payments of $889 to remediate the landfills at the end of their useful lives. These payments are expected to occur within the next 12 months and have been recorded in accounts payable. Of the opening balance $nil was recorded as a provision and $853 was recorded in accounts payable at December 31, 2011.

The following table reflects changes in the provision for the landfill related asset retirement obligations:

	December 31, 2012 $
Opening balance	853
Change in estimated costs of capping existing landfills	161
Landfill maintenance payments	(125)
Balance at end of year	889
Less: current portion included in accounts payable	(889)
Long-term asset retirement obligation	–

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

Customer provisions

As at December 31, 2011 and 2012, a customer dispute existed for product supplied by the Company. The complaint was the result of a faulty input which was provided by a third party supplier of the Company. Any amounts under dispute will need to be reimbursed to the Company by the supplier. The amount and likelihood of any dispute settlement with the customer is indeterminable. As a result, the following amounts were recorded during 2011:

	$
Amounts payable to third party supplier	(988)
Inventory on hand provided for	4,313
Accounts receivable provided for	2,904
	6,229
Amount recorded as other receivable	6,229
Net effect to the Company	–

The other receivable balance at December 31, 2012 is $6,241. The difference from prior year is made up of foreign exchange translation.

Environmental Remediation

On June 20, 2012, the Company purchased the assets of a mill in Lebel-sur-Quévillon, Québec. As part of the purchase, the Company entered into an environmental Trust Agreement (the “Environmental Trust”) to be used for environmental remediation for potential problems that existed at the date of purchase. The Company does not have access to, and cannot control, the funds in the Trust. The Company must fund $7.5 million over the next 5 years in the intervals set out below. The Company must also fund another $2.5 million in the event that the mill is dismantled in the future. The liability for the Company is for existing environmental liabilities at the date of purchase has been limited at the amounts set out above. Any further environmental remediation costs are to be paid by the previous owners of the mill and the provincial government. The discount rates used for the valuation of the long-term liability range from 6.8% to 8.0% depending on the timing of the expected payment. The discount rate used for the valuation of the $2.5 million provision is 9.8%.

	Long-term Liability $	Provision $
Environmental Trust Payments	7,500	2,500
Discount	(1,824)	(2,364)
Accretion	209	7
Net amount recorded	5,885	143
Less: current portion included in accounts payable	(500)	–
Long-term liability and provision	5,385	143

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

The timing of potential Environmental Trust payments are as follows:

	$
2013	500
2014	500
2015	1,500
2016	1,500
2017	3,500
Thereafter	2,500
Total potential Environmental Trust payments	10,000

13. EMPLOYEE FUTURE BENEFITS

The Company maintains a defined contribution pension plan in Canada. The total cost recognized in 2012 for the Company's contribution to the plan was $1,289 (2011: $1,123).

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, 2012.

Approximately $2,454 is expected to be contributed by the Company to all pension plans for the year ended December 31, 2013.

The status of the Company's defined benefit pension plan is as follows:

	Year Ended December 31, 2012 $	Year Ended December 31, 2011 $
Accrued benefit obligation		
Beginning of year	68,014	62,454
Service cost	1,348	1,839
Interest cost on accrued obligation	1,667	1,874
Benefit payments	(2,908)	(7,388)
Contributions by plan participants	1,165	1,140
Actuarial (gain) loss	(1,768)	7,119
Foreign exchange	271	972
End of year	67,789	68,010

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

Plan assets		
Fair value, beginning of year	61,556	64,222
Expected return on plan assets	2,409	2,597
Actuarial gain (loss)	2,054	(1,562)
Employer contributions	1,165	1,140
Employee contributions	1,165	1,140
Benefit payments	(2,908)	(7,388)
Foreign exchange	168	1,403
End of year	65,609	61,552
Funded status — plan (deficit) surplus	(2,180)	(6,458)

	Year Ended December 31, 2012 $	Year Ended December 31, 2011 $
Pension expense recognized in net income		
Current service cost	1,348	1,839
Interest cost	1,667	1,874
Expected return on plan assets	(2,409)	(2,597)
Net expense recognized in net income	606	1,116

	Year Ended December 31, 2012 $	Year Ended December 31, 2011 $
Actual return on plan assets		
Expected return	2,409	2,597
Actuarial gain (loss) on plan assets	2,054	(1,562)
Actual return on plan assets	4,463	1,035

	Year Ended December 31, 2012 $	Year Ended December 31, 2011 $
Amount recognized in other comprehensive income before taxes		
Actuarial gain (loss) on plan assets in current year	2,054	(1,562)
Actuarial gain (loss) on benefit obligation in current year	1,768	(7,119)
Gain (loss) recognized in other comprehensive income before taxes	3,822	(8,681)
Cumulative amount recognized in other comprehensive income before taxes	(6,926)	(10,748)

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

	December 31, 2012	December 31, 2011
Significant actuarial assumptions used are as follows	%	%
Discount rate to determine benefit obligations at end of year	2.1	2.5
Discount rate to determine benefit expense (income) for the year	2.5	2.9
Expected rate of return on plan assets	4.0	4.0
Rate of increase in future compensation	1.5	1.5
Future pension increases	0.0	0.0
Expected average remaining working lives in years	9.4	9.1
Plan assets at fair value at the end of the year	%	%
Liquid assets	2.5	9.0
Bonds	52.6	50.1
Equity	25.3	21.0
Real estate	19.6	19.9
	100.0	100.0

The expected return on plan assets is determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields as at the end of the reporting year. Expected returns on equity and property investments reflect long-term real rates of return experienced in the respective markets.

	December 31, 2012 $	December 31, 2011 $	December 31, 2010 $
Experience adjustments			
Plan liabilities using January 1 assumptions	64,590	63,317	60,185
Experience (gain) loss on plan liabilities	(4,762)	3,260	(813)
Expected plan assets with January 1 assumptions	63,542	63,000	65,028
Experience loss on plan assets	2,028	(1,490)	(749)

14. SHARE CAPITAL

(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**:

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

	Note	Number of Shares	Share Capital $
Balance, December 31, 2010		12,683,588	111,148
Private placement		1,112,050	54,782
Restricted Share Units vested	15	69,506	1,013
Options exercised	15	88,450	974
Shares issued on redemption of convertible debt		350,000	7,283
Balance, December 31, 2011		14,303,594	175,200
Restricted Share Units vested	15	115,481	2,013
Options exercised	15	76,000	839
Balance, December 31, 2012		14,495,075	178,052

During the year ended December 31, 2011, the Company completed a private placement of 1,112,050 shares for total net proceeds of $54,782 after transaction costs of $2,765.

Warrants

On June 20, 2012, the Company issued 715,000 warrants to a lender. The warrants have an exercise price of $21.52 and are exercisable from December 31, 2014 to December 31, 2017, when they expire. The warrants were valued at $8.62 per warrant at the grant date using the Black Scholes pricing model. The Black Scholes pricing model requires 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 warrants. Assumptions used in the pricing model are as follows:

	2012
Risk-free interest rate	1.3%
Expected life of warrants	5 years
Annualized volatility	51.2%
Dividend rate	Nil

All 715,000 warrants were outstanding as at December 31, 2012.

15. 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.

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

Stock Options

During the year ended December 31, 2012, 300,000 options were granted to employees of the Company. The weighted average fair value of the options granted in 2012 was $6.80 per option at the grant date using the Black Scholes option pricing model. During the year ended December 31, 2011 there were no options granted. Option pricing models require the input of highly subjective assumptions including the expected volatility. Expected volatility is based on historical Fortress stock performance. 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:

	2012
Risk-free interest rate	1.4%
Expected life of options	5 years
Annualized volatility	52.3%
Dividend rate	Nil

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

	Number of options	**Weighted Average Exercise Price $**
Balance, December 31, 2010	655,175	8.00
Exercised	(88,450)	8.00
Balance, December 31, 2011	566,725	8.00
Exercised	(76,000)	8.00
Cancellation	(100,000)	8.00
Granted	300,000	15.41
Balance, December 31, 2012	690,725	11.22

The following table summarizes stock options outstanding as at December 31, 2012:

Exercise Price $	**Number outstanding as at December 31, 2012**	**Weighted average remaining life of outstanding options (years)**	**Number exercisable as at December 31, 2012**	**Weighted average remaining life of exercisable options (years)**
8.00	390,725	4.64	390,725	4.64
15.41	300,000	9.67	200,000	9.66
	690,725	6.83	590,725	6.34

The following table summarizes stock options outstanding as at December 31, 2011:

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

Exercise Price $	Number outstanding as at December 31, 2011	Weighted average remaining life of outstanding options (years)	Number exercisable as at December 31, 2011	Weighted average remaining life of exercisable options (years)
8.00	566,725	5.74	566,725	5.74

Deferred Share Unit Awards

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

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

	Number of DSUs	Expense recognized $
Balance, December 31, 2010	139,023	5,470
Granted	3,850	172
Balance, December 31, 2011	142,873	5,642
Granted	6,797	163
Balance, December 31, 2012	149,670	5,805

Restricted Share Unit Awards

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

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

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

	Number of RSUs
Balance, December 31, 2010	315,042
Granted	17,128
Vested	(69,506)
Balance, December 31, 2011	262,664
Granted	60,869
Vested	(115,481)
Forfeited	(6,850)
Balance, December 31, 2012	201,202

For the RSU's forfeited during 2012, $40 was charged as a recovery of stock based compensation.

16. FINANCE INCOME AND EXPENSE

	December 31, 2012 $	**December 31, 2011 $**
Interest expense:		
Long-term debt interest	13,298	3,670
Accretion and other	5,121	1,755
	18,419	5,425
Less: amounts capitalized on qualifying assets	(3,105)	(1,409)
Total finance expense	15,314	4,016
Finance income – interest on short-term bank deposits	(355)	(293)
Net finance expense	14,959	3,723

17. EARNINGS PER SHARE

a) Basic

Basic earnings (loss) per share, is calculated by dividing the income (loss) attributable to equity holders of the Company by the weighted average number of common shares outstanding during the year.

	2012	**2011**
Loss attributable to equity holders of the Company	(20,887)	(19,230)
Weighted average number of common shares outstanding	14,379,012	11,283,646

b) Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of all dilutive potential common shares. The Company has four categories of dilutive potential common shares: convertible debt, stock options, RSUs and DSUs. The convertible debt is assumed to have been converted into common shares, and the net income is adjusted to eliminate the interest expense less the tax effect. For the stock options, a calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding stock options. The number of shares calculated reduces the number of shares that would have been issued assuming the exercise of the share options. RSUs and DSUs are assumed to be converted as of the grant date.

Adjustments for the weighted average number of common shares of 3,144,790 (2011: 825,798) for convertible debt, stock options, warrants, RSUs and DSUs have not been included in the calculation for diluted loss per share as they are antidilutive.

18. GOVERNMENT ASSISTANCE

Pulp and paper green transformation fund

On June 17, 2009, the Canadian federal government announced the Pulp and Paper Green Transformation Program ("the Program"). The Program is designed as a reimbursement of funds to be spent on qualifying energy and environmental capital projects, credits may be used until the Program end date of March 31, 2012. The Company has been allocated $9.9 million from the Program on June 28, 2011. The Company has received Program approval to apply the funding to the installation of lime kiln and recovery boiler upgrades at the Fortress Specialty Cellulose mill. These projects are expected to provide economic and environmental benefits to the Company's operations. As at December 31, 2011 the Company had received $8.9 million under the Program. The remaining $1.0 million was received in 2012.

Investment grants

During 2012, the Dresden Papier mill received state and federal grants totalling EUR 554 (2011: EUR 518) for property, plant and equipment investments. There are no repayment obligations as of December 31, 2012. The grants were recorded as a reduction of property, plant and equipment.

Training grants

During 2012, the Fortress Specialty Cellulose mill recorded $983 (2011: $1,279) in training grants from the Québec provincial government as a reduction of costs. Of this amount, $112 has been recorded as other receivables. There are no repayment obligations as of December 31, 2012.

Investment and other tax credits

The Company has recorded $468 for refundable investment and other tax credits from the Canada and Québec governments relating to qualifying plant and equipment purchases made during the year ended December 31, 2012 (2011: $14,088).

The Company has recorded non-refundable investment and other tax credits from the Canada and Québec governments totalling $6,012 recorded as deferred income tax assets. Of this amount, $3,790 relates to the year ended December 31, 2012, and $2,222 relates to the year ended December 31, 2011.

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

19. COMMITMENTS

As at December 31, 2012, the Company has committed to purchase $8.3 million in property, plant, and equipment.

As at December 31, 2012, the Company has performance bonds in the amounts of EUR 6,093.

As at December 31, 2012, the Company has committed to purchase steam from a supplier up to the end of 2015 for CHF 900 per year.

The minimum operating lease commitments for equipment and offices over the next five years and thereafter are as follows:

	$
2013	999
2014	176
2015	87
2016	67
2017	17
Thereafter	3
	1,349

20. RELATED PARTIES

The remuneration of directors and other key management personnel was as follows:

	December 31, 2012 $	December 31, 2011 $
Salaries and other short-term employee benefits	3,187	4,667
Share-based awards	3,056	1,723
Total	6,243	6,390

21. SEGMENTED INFORMATION

The segmentation of the Company's manufacturing operations is based on a number of factors, including production, production processes, and economic characteristics. The Landqart mill and Fortress Optical Features produce security papers and products. The Dresden mill produces non-woven wallpaper base products and is included in the specialty papers segment. Fortress Specialty Cellulose produces dissolving pulp products. No single customer accounted for greater than 10% of sales. All pulp production is sold through an external agent that takes ownership of the inventory before it is sold to the end user.

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

	Year ended December 31, 2012				
	Specialty $	Security $	Dissolving Pulp $	Corporate $	Fortress Consolidated $
Sales	150,516	57,066	106,857	-	314,439
Operating income (loss)	34,026	(30,840)	(23,603)	(8,951)	(29,368)
Amortization[1]	(3,495)	(7,742)	(7,927)	-	(19,164)
Stock-based compensation[1]	-	-	-	(3,516)	(3,516)
Capital expenditures	4,364	1,363	106,333	-	112,060
Total assets	63,658	140,540	361,894	11,862	577,954

Sales by geographic area	%
Europe	53.7
Asia	43.2
North America	0.4
Other	2.7
Total	100.0

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

	Year ended December 31, 2011				
	Specialty $	Security $	Pulp $	Corporate $	Fortress Consolidated $
Sales	144,226	54,206	110,481	-	308,913
Operating income (loss)	28,353	(30,885)	(692)	(9,739)	(12,963)
Amortization[1]	(3,112)	(7,752)	(3,499)	-	(14,363)
Stock-based compensation[1]	-	-	-	(1,900)	(1,900)
Capital expenditures	10,208	18,848	136,582	-	165,638
Total assets	60,515	142,379	278,944	9,471	491,309

Sales by geographic area	%
Europe	60.2
Asia	32.0
North America	1.0
Other	6.8
Total	100.0

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

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

	December 31, 2012 $	December 31, 2011 $
Property, plant and equipment by location		
Canada	316,042	210,561
Switzerland	95,846	102,139
Germany	28,339	27,649
Total	440,227	340,349

22. SUPPLEMENTARY CASH FLOW INFORMATION

Non-cash items

The change in non-cash property, plant and equipment purchases included in accounts payable was $19,416 at December 31, 2012 and ($27,587) at December 31, 2011.

During the year ended December 31, 2011, 350,000 common shares of the Company were issued as part of the redemption of a convertible note.

23. FINANCIAL RISK MANAGEMENT

a. Financial risk factors

The Company's activities expose it to a variety of financial risks: credit risk, liquidity risk and market risk (including currency risk, fair value interest rate risk and cash flow interest rate 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. Credit risk is managed on a Company basis, except for credit risk relating to accounts receivable balances. Each local entity is responsible for managing and analyzing the credit risk for each of their new clients before standard payment and delivery terms and conditions are offered. Credit risk arises from cash and cash equivalents, and deposits with banks and financial institutions, as well as credit exposures to customers.

Cash and cash equivalents include cash on deposit and cash equivalents 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, 2012 was $31.5 million (2011: $22.9 million).

The Company utilizes a combination of credit insurance and factoring to manage the risk associated with trade receivables. Approximately 59% of the outstanding trade receivables are covered under credit insurance or backed by letters of credit. The majority of the balance is with large and financially sound customers, including national banks. The Company sells all pulp through a third party agent that takes ownership of the inventory before it is delivered to the final customer. Accounts receivable aged greater than 90 days are $789 of which $416 is provided for as potentially impaired. The remaining amount is considered collectable. The Company's trade receivable balance at December 31, 2012 was $13.8 million (2011: $10.6 million).

Included in other accounts receivables is a $6.2 million receivable from a supplier related to a dispute where amounts have not been determined. It is management's best estimate that the amount will be collectible from the supplier and insurance; however, amounts collected could differ materially from what is recorded. If the dispute with the customer of the Company exceeds this amount, further reimbursement will be sought from the supplier.

Liquidity Risk

Liquidity risk is the risk that the Company will be unable to meet its financial obligations as they fall due. Cash flow forecasting is performed in the operating entities of the Company in and aggregated by Company finance. Company finance monitors rolling forecasts of the Company's liquidity requirements to ensure it has sufficient cash to meet operational needs while not breaching borrowing limits or covenants. 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, 2012, the Company's accounts payable and accrued liabilities totaled $79.8 million (2011: $86.1 million), all of which fall due for payment within one year of the statement of financial position 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 equity financings, 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 dissolving pulp, 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 fixed and variable interest rates. 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 American dollars. The Company's products are sold globally with prices denominated primarily in Euros, Swiss Francs and American dollars. The majority of the Company's expenditures are denominated in Euros, Swiss Francs and Canadian dollars. In addition, the Company holds financial assets and liabilities in the local operating currencies.

For the years ended December 31, 2012 and December 31, 2011, the Company did not use derivative instruments to reduce its exposure to currency risk for sales denominated in a foreign currency.

Sensitivity analysis:

The Company has completed a sensitivity analysis to estimate the impact on operating earnings for the year that a change in foreign exchange rates or interest rates during the year ended December 31, 2012 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 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 operating income $	
Change of + 1% in CHF foreign exchange rate	-	304
Change of + 1% in EUR foreign exchange rate	+	742
Change of + 1% in USD foreign exchange rate	+	968

The above results arise due to the combined impact of foreign currency fluctuations on operations and the translation of operations into the Company's functional currency. The currency risk is partially mitigated by both revenues and expenses being denominated in local currencies in Landqart and Dresden. Fortress will continue to monitor and evaluate the future use of exchange contracts to limit exposure to exchange fluctuations.

Changes in market interest rates would have no significant impact on operating income.

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.

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

b. Capital management

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, American dollar, and Euro.

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

	December 31, 2012 $	December 31, 2011 $
Cash and cash equivalents	31,491	22,897
Less total debt	255,901	152,408
Net (debt) cash	(224,410)	(129,511)
Shareholders' equity	229,330	231,639

The Company has certain financial covenants stipulating maximum net debt to capitalization ratios, maximum debt to earnings before interest, taxes, amortization and amortization ratios, and minimum current ratios. Debt obligations are held by various entities within the Company with individual debt agreements specifying the entities within the Company that are to be included in the covenant calculations.

The Company's strategy is to ensure it remains in compliance with all of its existing debt covenants in order to ensure continuous access to capital. Management reviews past results and forecasts to monitor their compliance. The Company was in compliance with all externally imposed capital requirements for the years ended December 31, 2012 and December 31, 2011.

24. SUBSEQUENT EVENT

In March of 2013, the Company entered into a new credit facility for approximately $20.3 million with an interest rate of three month EURIBOR plus 3.1% per annum and maturity dates of 2016 and 2018.