



CONDENSED CONSOLIDATED FINANCIAL STATEMENTS



**FOR THE THREE MONTHS ENDED
MARCH 31, 2017**

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

	Note	March 31, 2017 \$	December 31, 2016 \$
ASSETS			
Current			
Cash and cash equivalents		40,453	22,132
Restricted cash		17,354	15,010
Trade accounts receivable		22,602	24,949
Other accounts receivable		12,977	7,399
Inventories		50,624	57,553
Prepaid expenses		2,610	2,217
		146,620	129,260
Other long-term receivable		7,000	7,000
Property, plant and equipment	5	340,000	345,289
		493,620	481,549
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities		48,840	49,785
Financial instruments	4	–	26
Current portion of long-term debt	6	4,425	25,851
		53,265	75,662
Long-term debt	6	205,419	171,929
Deferred income taxes		133	133
Provisions and other long-term liabilities		12,558	12,487
Employee future benefits		8,116	10,789
		279,491	271,000
Shareholders' equity			
Share capital	7	175,512	175,445
Treasury shares	7	–	(2,357)
Contributed surplus		24,266	24,208
Retained deficit		(17,405)	(17,636)
Accumulated other comprehensive income		31,756	30,889
		214,129	210,549
		493,620	481,549
Commitments	9		

(See accompanying notes)

Approved by the Board of Directors:

“Chadwick Wasilenkoff”

Director

“Anil Wirasekara”

Director

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Canadian dollars, amounts in thousands except share and per share data, unaudited)

Note	Three Months Ended March 31, 2017 \$	Three Months Ended March 31, 2016 \$
Sales	92,460	80,012
Costs and expenses		
Manufacturing and distribution costs	(72,205)	(65,781)
Amortization	(8,522)	(7,882)
Selling, general and administration	(12,766)	(13,176)
Stock-based compensation	(125)	(41)
Operating loss	(1,158)	(6,868)
Other income (expense)		
Finance expense	(4,517)	(5,237)
Finance income	6	2,671
Gain (loss) on financial instruments	4	26
Foreign exchange gain (loss)	254	(852)
Net loss from operations before taxes	(2,724)	(13,036)
Income tax expense	(21)	(5)
Net loss	(2,745)	(13,041)
Net loss and diluted loss per share	(0.19)	(0.88)
Weighted average number of shares outstanding Basic and diluted	14,311,336	14,802,924

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Canadian dollars, amounts in thousands, unaudited)

	Three Months Ended March 31, 2017 \$	Three Months Ended March 31, 2016 \$
Net loss	(2,745)	(13,041)
Other comprehensive loss		
Items that may be reclassified subsequently to net loss		
Exchange differences on translation of foreign operations	867	(1,876)
Items that will not be reclassified to net loss		
Actuarial gain (loss) recognized on employee future benefits (net of taxes of \$nil and \$nil)	2,976	(3,950)
Total other comprehensive income (loss)	3,843	(5,826)
Total comprehensive income (loss)	1,098	(18,867)

(See accompanying notes)

FORTRESS PAPER LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Canadian dollars, amounts in thousands, unaudited)

Note	Three Months Ended March 31, 2017 \$	Three Months Ended March 31, 2016 \$
Share capital		
7		
Balance at beginning of period	175,445	182,204
Restricted share units vested	67	246
Deferred share units vested	-	281
Balance at end of period	175,512	182,731
Treasury shares		
Balance at beginning of period	(2,357)	-
Reversal of liability	2,357	-
Balance at end of period	-	-
Contributed surplus		
Balance at beginning of period	24,208	25,318
Stock-based compensation	125	41
Restricted share units vested	(67)	(246)
Deferred share units vested	-	(281)
Balance at end of period	24,266	24,832
Retained deficit		
Balance at beginning of period	(17,636)	(26,776)
Net loss	(2,745)	(13,041)
Defined benefit plan actuarial gain (loss), net of tax	2,976	(3,950)
Balance at end of period	(17,405)	(43,767)
Accumulated other comprehensive income		
Balance at beginning of period	30,889	35,202
Cumulative translation adjustment on foreign operations	867	(1,876)
Balance at end of period	31,756	33,326
Total equity	214,129	197,122

(See accompanying notes)

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

Note	Three Months Ended March 31, 2017 \$	Three Months Ended March 31, 2016 \$
Cash flows from (used by) operating activities		
	(2,745)	(13,041)
Net loss for the period		
Adjustments:		
	(26)	137
	8,522	7,882
	21	5
	147	1,079
	1,846	5,179
	194	240
	125	41
	8,084	1,522
Change in non-cash working capital items		
	1,619	148
	7,115	2,521
	(388)	(806)
	(999)	(4,377)
	15,431	(992)
Cash flows from (used by) financing activities		
	(836)	(447)
	(25,000)	(27)
	38,653	-
	(1,480)	-
	11,337	(474)
Cash flows from (used by) investing activities		
	(6,946)	(6,896)
	-	581
	500	-
	50	58
	(2,230)	6,192
	(8,626)	(65)
Increase (decrease) in cash position		
	18,142	(1,531)
	179	(840)
	22,132	33,964
Cash and cash equivalents, end of period		
	40,453	31,593

(See accompanying notes)

FORTRESS PAPER LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the three months ended March 31, 2017 and 2016
(Canadian dollars, amounts in thousands except share and per share data, unaudited)

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. Fortress operates internationally in two distinct business segments: dissolving pulp and security paper products. The Company operates its dissolving pulp business at the Fortress Specialty Cellulose mill located in Canada which also operates a cogeneration facility that produces renewable energy. 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.

2. BASIS OF PRESENTATION

These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board (“IASB”). The Board of Directors approved these statements on May 10, 2017.

These unaudited interim financial statements do not include all of the disclosures required by International Financial Reporting Standards (“IFRS”) for annual financial statements and, accordingly, should be read in conjunction with the consolidated financial statements and notes as at and for the year ended December 31, 2016 (available on SEDAR at www.sedar.com). These unaudited interim condensed consolidated financial statements follow the same accounting policies and methods of their application that were applied in the December 31, 2016 consolidated financial statements. For significant estimates and judgments refer to notes 4 and 5 as well as the consolidated financial statements and notes as at and for the year ended December 31, 2016.

3. NEW ACCOUNTING PRONOUNCEMENTS

Accounting standards issued and not applied

IFRS 16 – Leases

In January 2016, the IASB issued IFRS 16, *Leases*, which requires, among other things, lessees to recognize leases traditionally recorded as operating leases in the same manner as a financing lease. The required adoption date is January 1, 2019, with early adoption permitted. The Company is currently evaluating the impact from the adoption of this standard.

IFRS 9 – Financial Instruments - Classification and Measurement

The final version of IFRS 9 was issued in July 2014 and includes (i) a third measurement category for financial assets, and (ii) a single forward looking expected loss impairment model. IFRS 9 is effective for annual periods beginning on or after January 1, 2018. The Company does not anticipate the new standard to have a significant impact on its financial statements.

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Amendments to IFRS 7 - Financial Instruments: Disclosures

IFRS 7 is amended to require additional disclosures on transition from IAS 39 to IFRS 9. The Amendment of IFRS 7 is effective on adoption of IFRS 9.

IFRS 15 - Revenue from Contracts with Customers

This new standard on revenue recognition supersedes IAS 18 - Revenue, IAS 11 - Construction Contracts, and related interpretations. IFRS 15 is effective for first interim periods beginning on or after January 1, 2018. The Company is currently performing a preliminary assessment of the new standards with the assessment to be finalized in the second half of 2017.

There are no other standards, amendments, or interpretations to existing standards issued but not yet effective which are expected to have a material impact on our consolidated statements.

4. FINANCIAL INSTRUMENTS

The Company's cash and cash equivalents, restricted cash, trade accounts receivable, other accounts receivable, other long-term receivable, accounts payable and accrued liabilities, and long term debt are measured at amortized cost subsequent to initial measurement. Marketable securities and derivative financial instruments are measured at fair value through profit and loss in accordance with IAS 39, *Financial Instruments: Recognition and Measurement* and IFRS 13, *Fair Value Measurement*, which requires the classification of financial instruments within a hierarchy that prioritizes the inputs to fair value measurement. The Company uses a variety of derivative financial instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates.

The three levels of the fair value hierarchy are:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly;

Level 3 – Inputs that are unobservable for the asset or liability.

The following table summarizes the Company's financial instruments measured at fair value at March 31, 2017 and December 31, 2016, and shows the level within the fair value hierarchy in which they have been classified:

	Fair Value Hierarchy Level	March 31, 2017 \$	December 31, 2016 \$
Derivative financial instruments – held for trading	Level 2	–	(26)
Total financial instruments		–	(26)

The following table summarizes the loss on financial instruments for the three months ended March 31, 2017 and March 31, 2016, respectively:

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	Three Months Ended March 31, 2017 \$	Three Months Ended March 31, 2016 \$
Marketable securities	-	(137)
Derivative financial instrument US dollar collars and variable rate forwards	26	-
Gain (loss) on financial instruments	26	(137)

The Company had the following foreign exchange derivatives at March 31, 2017 and December 31, 2016:

	March 31, 2017		December 31, 2016	
	Notional Amount US dollars	Exchange Rates protection/ topside, per dollar	Notional Amount US dollars	Exchange Rates protection/ topside, per dollar
US dollar collars and variable rate forwards 0-12 Months	-	-	3,000	1.28/1.39

5. PROPERTY, PLANT AND EQUIPMENT

Impairment of property, plant and equipment

In accordance with the Company's accounting policy, each asset or cash generating unit is evaluated at each reporting date to determine whether there are any indicators of impairment. If any such indication exists, a formal estimate of recoverable amount is performed and an impairment loss is recognized to the extent that the carrying amount exceeds the recoverable amount. The recoverable amount has been determined by the Company as the value in use.

The determination of value in use requires management to make estimates and assumptions about expected production and sales volumes, prices, operating costs, capital expenditures, and appropriate discount rates for future cash flows. The estimate and assumptions are subject to risk and uncertainty, and as such there is the possibility that changes in circumstances will alter these projections, which may impact the recoverable amount of the assets. In such circumstances, some or all of the carrying value of the assets may be further impaired or the impairment charge reduced with the impact recorded in the statement of operations.

As at March 31, 2017, the Company's market capitalization was lower than the carrying amount of its net assets. Management of the Company determined that this constituted an impairment indicator and completed separate impairment assessments of the Fortress Specialty Cellulose and Landqart mills.

Management used consistent valuation models as those used at December 31, 2016 adjusted for updated key assumptions. Management's impairment evaluation did not result in the identification of an impairment loss at the Fortress Specialty Cellulose mill or the Landqart mill as at March 31, 2017.

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6. LONG-TERM DEBT

Note	March 31, 2017 \$	December 31, 2016 \$
Credit facilities with lenders		
CHF 1,988 (2016: CHF 2,375), interest at 0%, maturing 2020, unsecured	2,482	2,940
CHF 2,079 (2016: CHF 2,048), interest at 2.3%, maturing 2024, secured by certain assets of the Landqart mill	2,770	2,706
\$99,469 (2016: \$99,469) interest at 6.0% and 5.0%, maturing 2026, secured by the assets of the Fortress Specialty Cellulose mill	109,166	110,788
\$39,675 (2016: nil) interest at 6.5%, maturing 2031, secured by certain assets of the Fortress Specialty Cellulose mill	38,319	-
Unsecured convertible debentures		
\$25,000 principal, interest at 7%, maturing June 2017	-	24,633
\$62,100 principal, interest at 7%, maturing December 2019	57,107	56,713
	209,844	197,780
Less: Current portion	(4,425)	(25,851)
Long-term debt	205,419	171,929

	March 31, 2017 \$	December 31, 2016 \$
Principal value of debt	206,661	192,413
Adjustments for unamortized borrowing costs, amounts allocated to equity for convertible debentures, and expected contingent payments	3,183	5,367
Net amount recorded in liabilities	209,844	197,780

At March 31, 2017, the fair value of the long-term debt, measured at its amortized cost of \$209,844 was \$212,063. The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

Borrowings under the above agreements require maintenance of subsidiary specific minimum ratios of working capital and debt to earnings, maximum ratios of long-term debt to adjusted net worth and debt service coverage, as well as certain non-financial covenants. The Company has been in compliance with all covenants for all periods presented.

At March 31, 2017, the Company's current portion of long term debt, accounts payable and accrued liabilities totaled \$53,265, all of which fall due for payment within one year of the statement of financial position date. If

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necessary, the Company has the ability to repay principal amounts outstanding, subject to receiving requisite approvals, of the \$62,100 of convertible debentures due in 2019, in common shares of the Company. Although there can be no assurances, the Company believes that current cash, cash generated from operations, cashflow derived from improved inventory and cash management, alternative financing arrangements, and other cash generating initiatives, should be sufficient to meet its debt service, capital expenditure and short term working capital requirements. The Company's future operating performance and its ability to service its debt and pay other indebtedness will be subject to future economic conditions and the financial success of the Company's business and other factors, many of which are not within the Company's control, including changes in market prices for its dissolving pulp, security papers and raw material costs.

- (a) The company entered into a loan for up to \$3,997 (CHF 3,000) for the construction of production equipment at the Landqart mill of which \$2,770 (CHF 2,079) has been drawn as at March 31, 2017. Interest will be charged at 2.3% per year with repayment of the loan over a seven year period.
- (b) The Company entered into an addendum to a loan agreement with the lender in January 2017 which indicated that interest on the loan will not commence until April 1, 2018.

The lender agreed to subordinate their security rights in relation to the cogeneration assets of the Dissolving Pulp segment in favour of a new lender (Note 6(c)). In consideration of this subordination, the Company agreed to increase the interest rate payable on \$40,000 principal amount of the loan owing to the lender to 6% per annum and began paying interest on this portion of the loan in February of 2017. All principal payments to the lender will be applied firstly to the higher interest bearing principal amount outstanding. A net gain of \$2,624 was recorded as finance income relating to the changes in the facility.

- (c) The Company entered into an agreement with a new lender for a \$40,000 secured loan. The loan matures in 14 years from the advance date of February 2, 2017, and is repayable in monthly payments of principal and interest over the term. The loan accrues interest at a rate of 6% per annum plus an account maintenance fee of 0.5% per annum. Security for the loan includes a charge against the cogeneration assets of the Dissolving Pulp segment and guarantees from Fortress Specialty Cellulose and Fortress Paper.
- (d) During the three months ended March 31 2017, the Company repaid in full the unsecured convertible debenture in the aggregate principal amount of \$25,000. The Company was granted the right by the lender to repay the principal amount owing prior to maturity, with all interest accrued to the date of repayment.

7. SHARE CAPITAL

Authorized

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

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Issued and fully paid — common shares

	Number of Shares	Share Capital \$
Balance, December 31, 2015	14,730,727	182,204
Balance, December 31, 2015	14,730,727	182,204
Restricted share units vested	40,851	289
Deferred share units vested	44,814	281
Repurchase of common shares	(655,300)	(8,085)
Exercise of warrants	125,000	756
Balance, December 31, 2016	14,286,092	175,445
Balance, December 31, 2016	14,286,092	175,445
Restricted share units vested	26,114	67
Balance, March 31, 2017	14,312,206	175,512

Treasury shares

During the year ended December 31, 2016, the Company contributed \$2,357 to an automatic share purchase plan pursuant to its normal course issuer bid. During the three months ended March 31, 2017, the funds in this plan were returned to the Company.

8. STOCK-BASED COMPENSATION

Stock options

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

	Number of options	Weighted Average Exercise Price \$
Balance, December 31, 2016	590,725	10.51
Balance, December 31, 2016	590,725	10.51
Granted	84,150	8.20
Balance, March 31, 2017	674,875	10.22

As at March 31, 2017, 590,725 stock options were exercisable (December 31, 2016: 590,725).

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During the three months ended March 31, 2017, the Company granted 84,150 stock options to an executive of the Company pursuant to an employment agreement. The options were issued in two tranches of 42,075 which vest within two years of the grant date based upon the 180 day volume weighted average common share price of the Company being greater than \$10 and \$15, respectively. Any remaining unvested options after two years from the grant date will be cancelled. The Company recorded \$5 in stock based compensation expense for the three months ended March 31, 2017 in relation to the award.

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, 2015	274,732	6,452
Granted	13,877	72
Vested	(44,814)	-
Balance, December 31, 2016	243,795	6,524
Balance, December 31, 2016	243,795	6,524
Granted	13,761	101
Balance, March 31, 2017	257,556	6,625

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:

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	Number of RSUs
Balance, December 31, 2015	223,295
Granted	8,571
Vested	(40,851)
Cancelled	(30,254)
Balance, December 31, 2016	160,761
Balance, December 31, 2016	160,761
Granted	4,860
Vested	(26,114)
Cancelled	(26,114)
Balance, March 31, 2017	113,393

9. COMMITMENTS

As at March 31, 2017, the Company has issued performance bonds in the amounts of \$27,381 (EUR 19,214). Restricted cash of \$8,587 has been set aside for these bonds.

As at March 31, 2017, the Company has issued guaranteed letters of credit of \$840 relating to the continued delivery of power at the cogeneration facility.

The Company has guaranteed a \$7,000 secured note receivable transferred to a lender as early repayment of principal amounts due in 2017.

As at March 31, 2017, the Company has committed to purchase steam from a supplier up to the end of 2025 for \$1,199 (CHF 900).

As at March 31, 2017, the Company has committed to purchase \$9,791 in property, plant and equipment.

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

	\$
2017	4,313
2018	4,335
2019	4,274
2020	4,039
2021	3,664
Thereafter	53,125
	73,750

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10. SEGMENTED INFORMATION

The segmentation of the Company's manufacturing operations is based on a number of factors, including production and economic characteristics. The Landqart mill produced security papers and products and Fortress Specialty Cellulose produces dissolving pulp products.

	Three months ended March 31, 2017			
	Security	Pulp	Corporate	Fortress Paper Consolidated
	\$	\$	\$	\$
Sales	43,770	48,690	-	92,460
Operating (loss) income	(652)	1,905	(2,411)	(1,158)
Amortization ¹	(2,120)	(6,402)	-	(8,522)
Stock-based compensation ¹	-	-	(125)	(125)
Capital expenditures	1,612	1,166	-	2,778
Total assets	121,673	350,184	21,763	493,620

Sales by geographic area	%
Europe	7.4
Asia	87.1
Canada	5.5
Other	-
Total	100.0

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

	Three months ended March 31, 2016			
	Security	Pulp	Corporate	Fortress Paper Consolidated
	\$	\$	\$	\$
Sales	41,210	38,802	-	80,012
Operating loss	(732)	(4,041)	(2,095)	(6,868)
Amortization ¹	(2,576)	(5,306)	-	(7,882)
Stock-based compensation ¹	-	-	(41)	(41)
Capital expenditures	849	1,768	-	2,617
Total assets	150,799	337,245	25,511	513,555

Sales by geographic area	%
Europe	2.0
Asia	87.8
Canada	6.3
Other	3.9
Total	100.0

¹Stock-based compensation and amortization are included in operating loss.