FORTRESS PAPER

# MANAGEMENT'S DISCUSSION AND ANALYSIS


## FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2017

Please visit www.sedar.com for Fortress Paper Ltd. company filings

FTP LISTED TSX

**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") is dated and has been prepared based on information available as at August 11, 2017. The MD&A should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto for the three and six month periods ended June 30, 2017 (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 June 30, 2017 relative to the previous quarter and prior year comparative quarter. The financial information contained herein has been prepared in accordance with International Accounting Standards ("IAS") 34 – Interim Financial Reporting as issued by the International Accounting Standards Board ("IASB").

This MD&A contains certain forward-looking information that reflects the current views and/or expectations of the Company with respect to its expectations, beliefs, assumptions, estimates and forecasts about its business and the industries 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 statements regarding: growth and future prospects of our business; market conditions for dissolving pulp, viscose staple fibre, security papers and other products; benefits that may accrue to the Company as a result of certain acquisitions, dispositions, capital expenditure programs, equipment upgrades and maintenance shutdowns; expected operational performance figures, including costs, utilization rates and efficiencies; expected returns on certain business segments; expected shipment dates to new customers at the Landqart mill; possible elimination of anti-dumping duties; expectation on continuity of current order book at the Landqart mill; 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; the securement of new purchase orders for our products; and the anticipated benefits for programs and initiatives.

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 realize significant cost-savings from production improvements and cost reduction initiatives; that demand for viscose staple fibre will continue to grow which will result in an increased demand for dissolving pulp; that the Landqart mill will continue operating on a consistent and regular basis in order to produce and deliver on its banknote orders; that the cogeneration facility will continue operating on a consistent and regular basis; that the Landqart mill will be successful in securing new orders; the general stability of the economic, political and regulatory environments within the countries where the Company conducts operations; that the Company will be able to enter into enforceable supply agreements for dissolving pulp on favourable terms and diversify its customer base; 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; 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; fluctuations in the market price for products sold; trade restrictions or import duties imposed by foreign governments; that the Company will not be able to meet its equipment repair targets; that the Company's continuing efforts to reverse the dissolving pulp antidumping duty will not be successful; failure to meet regulatory requirements; changes in the market; potential downturns in economic conditions; fluctuations in the price and supply of required materials; foreign exchange fluctuations; availability of financing (as necessary); dependence on major customers; and other risk factors detailed in 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 update any forward-looking information, except as required by applicable securities law.

Throughout this discussion, reference is made to “operating 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”, calculated as net loss less specific items affecting comparability with prior periods and “adjusted net loss per share”, calculated as adjusted net loss divided by the weighted average number of shares outstanding in the period. Operating EBITDA, adjusted net loss and adjusted net 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 operating EBITDA, adjusted net loss and adjusted net loss per share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of operating EBITDA and adjusted net loss to net income (loss) reported in accordance with IFRS and, on a segmented basis, operating income (loss) are included in this MD&A.

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, 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.

Where we disclose production costs in this MD&A, such costs are calculated based on a variety of factors and inputs which may result in such costs not being comparable to similar types of costs disclosed by other issuers.

**Description of Business**

The Company was incorporated on May 30, 2006 under the laws of the Province of British Columbia. During the quarter ended June 30, 2017, the Company operated internationally in two distinct business segments: the Dissolving Pulp Segment and the Security Paper Products Segment.

The Company operates its dissolving pulp business through the Fortress Specialty Cellulose (“FSC”) mill located in Thurso, Québec, Canada, that also operates in the renewable energy generation sector through its cogeneration facility. The Company operates its security paper products business through the Landqart mill located in Switzerland, where it produces banknote, passport, visa and other brand protection and security papers. The segmentation of the Company's manufacturing operations is based on a number of factors, including production, production processes, and economic characteristics. Consistent with the Company’s overall strategy, we continue to explore various shareholder enhancing opportunities, including investments in industries external to the Company’s current business segments, as well as joint venture, partnership and divestiture transactions. The Company’s core strengths involve identifying and capitalizing on investment opportunities and divestitures. In relation to these core strengths, the Company may pursue opportunities outside of the Company’s existing business segments that would diversify the asset base or monetize existing assets.

**Overall Performance**

Operating EBITDA was $4.3 million for the three months ended June 30, 2017, a decrease of $2.0 million versus the prior year comparative period and a decrease of $3.2 million over the previous quarter. The Dissolving Pulp

Segment and the Security Paper Products Segment generated operating EBITDA of $3.5 million and $2.8 million, respectively, and corporate costs were $2.0 million in the second quarter of 2017.

The Company reported a net loss of $2.1 million or basic and diluted net loss per share of $0.15 for the second quarter of 2017. In the first quarter of 2017, the Company reported net loss of $2.7 million or diluted net loss per share of $0.19. For the second quarter of 2016, the Company reported a net income of $6.9 million or basic and diluted net income per share of $0.47 and $0.45, respectively.

The Dissolving Pulp Segment generated operating EBITDA of $3.5 million for the quarter ended June 30, 2017, representing an increase of $0.3 million compared to the prior year comparative period and a decrease of $4.8 million compared to the first quarter of 2017. The results of the second quarter of 2017 were negatively impacted by approximately 6% lower realized sales price, higher production costs primarily due to some challenges experienced in the chemical recovery area of the mill and a three day planned outage that reduced production as compared to the first quarter of 2017. Relative to the prior year comparative period, higher production costs were more than offset by approximately 5% higher realized pricing. A total of 36,593 air dried metric tonnes ("ADMT") of dissolving pulp were produced in the second quarter of 2017. During the quarter ended June 30, 2017, the FSC mill sold 34,672 ADMT of dissolving pulp compared to 37,833 ADMT and 39,931 ADMT in the previous quarter and prior year comparative period, respectively.

The Security Paper Products Segment generated operating EBITDA of $2.8 million for the second quarter of 2017, an increase of $1.3 million when compared to the first quarter of 2017, and a $1.9 million decrease when compared to results in the second quarter of 2016. Waste rates improved relative to the first quarter of 2017; however, improved product mix is the primary reason for the increase in EBITDA compared to the previous quarter. Due to the sale and leaseback of the land and buildings in July 2016, quarterly rent of approximately $0.9 million has been incurred. The results of the second quarter of 2017 compared to the prior year comparative quarter were lower due primarily to rent and a less favourable product mix. The Landqart mill continues to implement new initiatives to improve efficiencies and profitability. The build-out and installation of the second finishing machine has been materially completed, is undergoing final testing and is on schedule to be fully operational before the end of the third quarter of 2017. The additional finishing machine is expected to de-bottle-neck the mill and provide more production flexibility. The Landqart mill sold 3,139 tonnes of security paper in the second quarter of 2017, compared to 2,836 and 2,714 tonnes of security paper in the first quarter of 2017 and second quarter of 2016, respectively. Security paper production includes banknotes and passports, which result in varying degrees of costs and margins depending on the complexity of the security features included.

## Management's Outlook

### *Dissolving Pulp Segment*

In the second quarter of 2017, the FSC mill's production costs, including amortization of some of the shutdown costs and the positive impact of the cogeneration facility, averaged $991 per ADMT. Production costs in the prior year comparative period averaged $903 per ADMT. Production efficiency and costs in the second quarter of 2017 were primarily impacted by the operational challenges experienced in the chemical recovery area of the mill and a three day planned outage. Corrective measures and efficiency initiatives have been identified and scheduled to be completed during the annual October shutdown. One component of the previously announced Birch and Hemicellulose Project is expected to permanently rectify the primary operational challenge experienced during the second quarter in the chemical recovery area. This phase of the project is to be completed during the annual shutdown in the fourth quarter of 2017. The shutdown is planned to be extended a few days this year due to the incremental work required in connection with the fifth digester project.

Ongoing initiatives to reduce operational costs are focused primarily in the following areas: improving productivity, reducing fuel consumption, increasing power generation, and reducing chemical costs. Despite the issues in the chemical recovery area, June 2017 experienced one of the highest months of production at the mill as well as one of the highest months of power generation due to the stability of the mill. Further, the fifth digester project, scheduled to be completed in the first quarter of 2018, is expected to result in an incremental annual production capacity increase of 8,500 ADMT in 2018 and 17,000 ADMT in 2019 compared to current production capacity.

Dissolving pulp pricing softened in June 2017 due primarily to a temporary build up in viscose staple fibre ("VSF") and yarn inventory levels, a drop in cotton linter prices and an increase in exports to China from an Indonesian pulp producer. However, weekly average pricing for dissolving pulp during the second quarter of 2017 was higher by $19 per ADMT compared to the second quarter of 2016. Over the last two months, VSF prices have recovered from recent weakness, returning to August 2016 levels. Management believes that demand is positive and growing, and expects full year 2017 average pricing to be comparable to full year 2016 average pricing. The recent volatility from the appreciation of the CAD compared to the USD will impact our third quarter 2017 operating results as our dissolving pulp sales are denominated in USD.

VSF price is also supported by improved cotton pricing over the past year. The latest U.S. Department of Agriculture cotton projections for 2017 and 2018 indicate world consumption should exceed production for the third consecutive season, with world cotton ending stocks set to decline during the 2017/2018 season to 88.7 million bales which would be the lowest level in five years. Reserve cotton sales will further reduce the large Chinese stockpile which is expected to improve stability in the cotton market. Ending stocks in China for 2017/2018 are projected to decline more than 19% to 39.3 million bales, the lowest level in six years. The supply of higher quality imported cotton remains limited. The decline in forecasted cotton production and the limited availability of higher quality cotton stocks continue to reinforce the shift to manmade materials, which has resulted in increased demand and price increases for textile feedstocks including VSF.

Management believes the medium and long-term growth prospects for the world textile and fibre markets should continue to improve with an increasing population and a growing middle class in certain markets. Worldwide use of fibre is projected to continue to increase for the next several years. Demand for manmade fibre has increased while demand for cotton has continued to decline. VSF demand is forecasted to continue to grow 5 to 6% per year as reported in The Fibre Year 2016, which is expected to lead to improved demand for dissolving pulp and better market dynamics relative to the past few years.

***Security Paper Products Segment***

The Landqart mill has a full order book for 2017 and continues to build out its 2018 order book comprised of a mix of new and repeat orders including for Durasafe®. Operating EBITDA at the Landqart mill for the quarter ended June 30, 2017 exceeded expectations due to a significant order shipping in the quarter that was originally planned for shipment in the third quarter of 2017. Operating EBITDA in the third quarter is expected to be lower when compared to the second quarter due to the aforementioned shipment and lower margin product mix.

Production of Durasafe® for the substrate of the ninth series of the Swiss franc for the Swiss National Bank ("SNB") began in 2014 and will continue for all series expected through to 2019. In April 2016, the SNB issued the new 50 franc note and in May 2017, SNB released the 20 franc, note both printed on Durasafe®. These are the first two of six notes in the SNB ninth series. In March 2016, the National Bank of Kazakhstan 20,000 Tenge banknote produced with Durasafe® banknote substrate was the recipient of the Regional Banknote of the Year award at the High Security Printing Europe conference. In April 2017, the Swiss 50 Franc was the recipient of the International Bank Note Society 2016 bank note of the year award. Based on multiple Durasafe® trials being conducted at various stages, management continues to anticipate additional orders in the near, medium and long term. In June 2017, the Central Bank of the Bahamas chose Durasafe® for the two highest denominations of its "Crisp Evolution" Series. See *"Significant Developments – New Durasafe Banknote Customer".*

The global market for security paper is growing. Specifically, demand for banknote currency is increasing globally and is expected to remain a significant method of payment in the foreseeable future.

## Significant Developments

### *OTCQX® Market Trading*

In April 2017, the Company announced that its common shares commenced trading on the OTCQX® Best Market in the United States under the symbol "FTPLF." The Company's common shares continue to trade on the Toronto Stock Exchange under the symbol "FTP".

### *Developments relating to Chinese Anti-Dumping Measures*

In April 2017, the Company announced that the World Trade Organization ("WTO") issued its final report finding generally in favour of Canada in the dispute relating to China's imposition of anti-dumping measures on Canada's dissolving pulp industry. The WTO panel concluded that China's Ministry of Commerce failed to conduct its injury investigation in accordance with its WTO obligations. The timeframe provided to China to comply with the decision will be negotiated by Canada and China or established by an independent arbitrator. At the end of this period, Canada could decide to initiate WTO compliance proceedings if it is of the view that China did not implement the panel's decision properly. Fortress is of the view that a proper implementation of the panel decision should result in China removing anti-dumping duties on imports of Canadian dissolving pulp.

### *New Durasafe® Banknote Customer*

In June 2017, the Company announced that the Central Bank of Bahamas had chosen to use Durasafe®, for the two highest denomination banknotes of its "Crisp Evolution" series. The Company expects that Landqart will commence shipments in 2018.

### *Retirement of Yvon Pelletier*

Effective October 1, 2017, Mr. Yvon Pelletier will retire as President and Chief Executive Officer of the Company after serving in this capacity for two years. Previously, Mr. Pelletier served as President of the Company's dissolving pulp business from February 2013 until October 2015. Under Mr. Pelletier's leadership, the Company experienced notable operational and financial improvements, and completed several significant transactions and financings. Mr. Pelletier will continue providing consulting services to the Company for up to two years in order to assist the Company in its transition subsequent to his departure. Mr. Chadwick Wasilenkoff, currently the Company's Executive Chairman, will replace Mr. Pelletier as President and Chief Executive Officer of the Company.

## Selected Quarterly Information

| (thousands of dollars, except per share amounts and foreign exchange rates, unaudited) | Q2 2017 | Q1 2017 | Q4 2016 | Q3 2016 |
|---|---|---|---|---|
| Sales | 86,599 | 92,460 | 80,863 | 82,148 |
| Net (loss) income | (2,087) | (2,745) | (7,274) | 20,301 |
| Basic net (loss) income per share | (0.15) | ($0.19) | ($0.51) | $1.38 |
| Diluted net (loss) income per share | (0.15) | ($0.19) | ($0.51) | $1.34 |
| Weighted average shares outstanding – Basic | 14,307 | 14,311 | 14,184 | 14,748 |
| Weighted average shares outstanding – Diluted | 14,307 | 14,311 | 14,184 | 15,149 |
| Average Swiss franc/Canadian dollar exchange rate(1) | 1.3664 | 1.3194 | 1.3327 | 1.3376 |
| Average US$/Canadian dollar exchange rate (1) | 1.3450 | 1.3238 | 1.3341 | 1.3050 |

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

| (thousands of dollars, except per share amounts and foreign exchange rates, unaudited) | Q2 2016 | Q1 2016 | Q4 2015 | Q3 2015 |
|---|---|---|---|---|
| Sales | 87,993 | 80,012 | 74,576 | 85,169 |
| Net income (loss) | 6,893 | (13,041) | (3,680) | (5,178) |
| Basic net income (loss) per share | $0.47 | ($0.88) | ($0.25) | ($0.35) |
| Diluted net income (loss)per share | $0.45 | ($0.88) | ($0.25) | ($0.35) |
| Weighted average shares outstanding – Basic | 14,812 | 14,803 | 14,727 | 14,709 |
| Weighted average shares outstanding – Diluted | 15,205 | 14,803 | 14,727 | 14,709 |
| Average Swiss franc/Canadian dollar exchange rate(1) | 1.3281 | 1.3819 | 1.3474 | 1.3563 |
| Average US$/Canadian dollar exchange rate (1) | 1.2886 | 1.3732 | 1.3354 | 1.3089 |

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

## Historical Discussion

The FSC mill recorded positive operating EBITDA in 2015, as a result of increased production, improved costs and increased dissolving pulp and electricity sales. Following the annual maintenance shutdown in the fourth quarter of 2015, the FSC mill experienced a challenging restart period. The fixed costs incurred during the shutdown, combined with the impact of the lime kiln repair, had a negative impact on the fourth quarter of 2015 costs in the amount of $2.6 million**.** The first quarter of 2016 saw improved pricing for dissolving pulp, continued stable electricity generation and favourable foreign exchange rates on sales primarily denominated in US$, offset by a ten day shutdown due to a blockage issue in the mill and limitations in digester capacity. The fixed costs incurred during the shutdown had a negative impact on first quarter costs in the amount of $2.5 million. The second quarter of 2016 results improved due to increased productivity and continued stable electricity generation. The third quarter saw improved productivity and production costs, continued stable electricity generation and improved pricing. The fourth quarter of 2016 was impacted by the planned annual maintenance shutdown. The results of the first quarter of 2017 were positively impacted by improvements in production rates and quality, particularly during the normally slower winter season, as well as better pricing relative to the prior year comparative period. The second quarter of 2017 was negatively impacted by operational challenges in the chemical recovery area of the mill.

The year ended December 31, 2015 was characterized by a favourable product mix and increased improvements in efficiency and waste rates at the Landqart mill, partially offset by the significant appreciation of the Swiss franc against the euro. The first half of 2016 was favourably impacted by product mix. The second half of 2016 was impacted by unfavourable product mix and technical challenges that led to mill inefficiencies. Results at the Landqart mill for the quarter ended March 31, 2017 were lower than the fourth quarter of 2016, due primarily to product mix. Results of the second quarter of 2017 were impacted by product mix and reduced waste rates.

**Second Quarter 2017 Earnings Review**

***Three Months Ended June 30, 2017***

*Overview*

Operating EBITDA was $4.3 million for the three months ended June 30, 2017. For the three months ended March 31, 2017, operating EBITDA was $7.5 million and for the three months ended June 30, 2016, operating EBITDA was $6.3 million. The Dissolving Pulp Segment generated operating EBITDA of $3.5 million and the Security Paper Products Segment generated operating EBITDA of $2.8 million. Corporate costs contributed an operating EBITDA loss of $2.0 million in the second quarter of 2017.

The Company reported a net loss of $2.1 million or basic and diluted net loss per share of $0.15 for the second quarter of 2017. In the first quarter of 2017, the Company reported net loss of $2.7 million or diluted net loss per share of $0.19. For the second quarter of 2016, the Company reported net income of $6.9 million or basic and diluted net income per share of $0.47 and $0.45, respectively.

Fortress reported an adjusted net loss of $8.2 million, or diluted adjusted net loss per share of $0.57 for the second quarter of 2017 on sales of $86.6 million. In the first quarter of 2017, the Company reported an adjusted net loss of $3.0 million, or diluted adjusted net loss per share of $0.21 on sales of $92.5 million, and for the second quarter of 2016, an adjusted net loss of $6.9 million or diluted adjusted net loss per share of $0.47 on sales of $88.0 million.

Manufacturing and distribution costs were $71.0 million, or 81.9% of sales, for the three months ended June 30, 2017, compared to $72.2 million, or 78.1% of sales, for the three months ended March 31, 2017. In the second quarter of 2016, manufacturing and distribution costs were $70.1 million, or 79.7% of sales. Such costs are representative of tonnage sold and production cost per tonne at each mill.

SG&A expenses were $11.9 million for the second quarter of 2017, compared to $12.8 million for the first quarter of 2017. SG&A was higher in the first quarter of 2017 compared to the current quarter due to elevated corporate activity and increased sales costs. The prior year comparative period SG&A was $11.6 million.

*Selected Financial Information and Statistics*

| (thousands of dollars, except shipments, unaudited) | **Q2 2017** | **Q1 2017** | **Q2 2016** |
|---|---|---|---|
| Sales | 86,599 | 92,460 | 87,993 |
| Operating EBITDA[1] | 4,289 | 7,489 | 6,307 |
| Net (loss) income | (2,087) | (2,745) | 6,893 |
| Adjusted net loss[2] | (8,193) | (2,999) | (6,921) |
| Paper shipments (tonnes) | 3,139 | 2,836 | 2,714 |
| Pulp shipments (ADMT) | 34,672 | 37,833 | 39,931 |

(1) See Net (Loss) Income to Operating EBITDA Reconciliation.

(2) See Net (Loss) Income to Adjusted Net Loss Reconciliation.

Net (Loss) Income to Adjusted Net Loss Reconciliation:

| (thousands of dollars, except per share amounts, unaudited) | Q2 2017 | Q1 2017 | Q2 2016 |
|---|---|---|---|
| Net (loss) Income | (2,087) | (2,745) | 6,893 |
| Foreign exchange (gain) loss | (3,907) | (254) | 561 |
| Gain on sale of property, plant and equipment | (8) | - | - |
| Reversal of legal provision | (2,731) | - | - |
| Nonrecurring salary adjustment | 540 | - | - |
| Reversal of impairment on property, plant and equipment | - | - | (14,375) |
| Adjusted net loss | (8,193) | (2,999) | (6,921) |
| | | | |
| Basic net (loss) income per share | (0.15) | (0.19) | 0.47 |
| Diluted net ( loss) income per share | (0.15) | (0.19) | 0.45 |
| Adjusted net loss per share, basic and diluted | (0.57) | (0.21) | (0.47) |

Net (Loss) Income to Operating EBITDA Reconciliation:

| (thousands of dollars, unaudited) | Q2 2017 | Q1 2017 | Q2 2016 |
|---|---|---|---|
| Net (loss) Income | (2,087) | (2,745) | 6,893 |
| Income tax expense | (17) | 21 | 5 |
| Foreign exchange (gain) loss | (3,907) | (254) | 561 |
| Net finance expense | 4,064 | 1,846 | 5,229 |
| Amortization | 8,586 | 8,522 | 7,672 |
| Gain on property, plant and equipment | (8) | - | - |
| (Gain) loss on financial instruments | (427) | (26) | 288 |
| Stock-based compensation | 276 | 125 | 34 |
| Reversal of legal provision | (2,731) | - | - |
| Non-recurring salary adjustment | 540 | - | - |
| Reversal of impairment on property, plant and equipment | - | - | (14,375) |
| Operating EBITDA | 4,289 | 7,489 | 6,307 |

***Operating Results by Business Segment***

*Dissolving Pulp Segment*

| (thousands of dollars, except for shipments, unaudited) | Q2 2017 | Q1 2017 | Q2 2016 |
|---|---|---|---|
| Sales | 42,808 | 48,690 | 43,780 |
| | | | |
| Operating (loss) income | (2,882) | 1,905 | (2,073) |
| Amortization | 6,359 | 6,402 | 5,316 |
| Operating EBITDA | 3,477 | 8,307 | 3,243 |
| | | | |
| Dissolving pulp shipments (ADMT) | 34,672 | 37,833 | 39,931 |

The Dissolving Pulp Segment generated operating EBITDA of $3.5 million for the quarter ended June 30, 2017, representing an increase of $0.3 million compared to the prior year comparative period and a decrease of $4.8 million compared to the first quarter of 2017. The results of the second quarter of 2017 were negatively impacted by approximately 6% lower realized sales price, higher production costs primarily due to challenges experienced in the chemical recovery area of the mill, as well as a three day planned outage that reduced production, as compared to the first quarter of 2017. Relative to the second quarter of 2016, higher production costs were more than offset by approximately 5% higher realized pricing. A total of 36,593 ADMT of dissolving pulp was produced in the second quarter of 2017. During the quarter ended June 30, 2017, the FSC mill sold 34,672 ADMT of dissolving pulp compared to 37,833 ADMT and 39,931 ADMT in the previous quarter and prior year comparative period, respectively.

Revenues of $5.3 million were generated from the cogeneration facility in the quarter ended June 30, 2017 compared to $5.1 million in the quarter ended March 31, 2017. Revenues from the generation of power at the cogeneration facility during the quarter ended June 30, 2016 were $4.7 million.

As at June 30, 2017, the FSC mill held finished goods inventory consisting of 3,812 ADMT of dissolving pulp compared to 1,891 ADMT as at March 31, 2017. At June 30, 2016, the mill held finished goods inventory consisting of 1,487 ADMT of dissolving pulp. Inventory levels at the end of June were higher than comparative periods but within the Company's expected range.

*Security Paper Products Segment*

| (thousands of dollars, except for shipments, unaudited) | Q2 2017 | Q1 2017 | Q2 2016 |
|---|---|---|---|
| Sales | 43,791 | 43,770 | 44,213 |
| Operating income (loss) | 54 | (652) | 2,314 |
| Non-recurring salary adjustment | 540 | - | - |
| Amortization | 2,227 | 2,120 | 2,356 |
| Operating EBITDA | 2,821 | 1,468 | 4,670 |
| Shipments (tonnes) | 3,139 | 2,836 | 2,714 |

The Security Paper Products Segment generated operating EBITDA of $2.8 million for the second quarter of 2017, an increase of $1.3 million when compared to the first quarter of 2017, and a $1.9 million decrease when compared to results in the second quarter of 2016. Waste rates improved relative to the first quarter of 2017; however, a more favourable product mix is the primary reason for the increase in EBITDA compared to the previous quarter. Due to the sale and leaseback of the land and buildings transaction in July 2016, quarterly rent of approximately $0.9 million has been incurred. The results of the second quarter of 2017 compared to the prior year comparative quarter were lower due primarily to rent and a less favourable product mix. The Landqart mill sold 3,139 tonnes of security paper in the second quarter of 2017, compared to 2,836 and 2,714 tonnes of security paper in the first quarter of 2017 and second quarter of 2016, respectively. Security paper production includes banknotes and passports, which result in varying degrees of costs and margins depending on the complexity of the security features included. In July 2017, a product claim in the Security Paper Products Segment dating back to July 2012 was dismissed by the courts and a $2.7 million reversal of a legal provision was recorded.

***Six Months Ended June 30, 2017***

*Selected Financial Information and Statistics for the Six Months Ended*:

| (thousands of dollars, except for shipments, unaudited) | June 30, 2017 | June 30, 2016 |
|---|---|---|
| Sales | 179,059 | 168,005 |
| Operating EBITDA(1) | 11,778 | 7,362 |
| Net loss | (4,832) | (6,148) |
| Adjusted net loss (2) | (11,192) | (19,110) |
| Paper shipments (tonnes) | 5,975 | 5,369 |
| Pulp shipments (ADMT) | 72,505 | 71,693 |

(1) See Net Loss to Operating EBITDA Reconciliation.

(2) See Net Loss to Adjusted Net Loss Reconciliation.

Net Loss to Adjusted Net Loss Reconciliation:

| (thousands of dollars, except per share amounts, unaudited) | June 30, 2017 | June 30, 2016 |
|---|---|---|
| Net loss | (4,832) | (6,148) |
| Foreign exchange (gain) loss | (4,161) | 1,413 |
| Gain on property, plant and equipment | (8) | - |
| Reversal of legal provision | (2,731) | - |
| Nonrecurring salary adjustment | 540 | - |
| Reversal of impairment of property, plant and equipment | - | (14,375) |
| Adjusted net loss | (11,192) | (19,110) |
| Basic and diluted net loss per share | (0.34) | (0.42) |
| Adjusted net loss per share, basic and diluted | (0.78) | (1.29) |

Net Loss to Operating EBITDA Reconciliation:

| (thousands of dollars, unaudited) | June 30, 2017 | June 30, 2016 |
|---|---|---|
| Net loss | (4,832) | (6,148) |
| Income tax | 4 | 10 |
| Foreign exchange (gain) loss | (4,161) | 1,413 |
| Net finance expense | 5,910 | 10,408 |
| Amortization | 17,108 | 15,554 |
| Gain on property, plant and equipment | (8) | - |
| (Gain) loss on financial instruments | (453) | 425 |
| Stock based compensation | 401 | 75 |
| Reversal of legal provision | (2,731) | - |
| Non-recurring salary adjustment | 540 | - |
| Reversal of impairment of property, plant and equipment | - | (14,375) |
| Operating EBITDA | 11,778 | 7,362 |

*Overview*

During the six months ended June 30, 2017, the Company reported net loss of $4.8 million or diluted net loss per share of $0.34. During the six months ended June 30, 2016, the Company reported net loss of $6.1 million or diluted net loss per share of $0.42.

Operating EBITDA for the Company was $11.8 million for the six months ended June 30, 2017 on sales of $179.1 million compared to operating EBITDA of $7.4 million for the six months ended June 30, 2016 on sales of $168.0 million.

During the six months ended June 30, 2017, the Dissolving Pulp Segment generated an operating EBITDA of approximately $11.8 million compared to $4.5 million operating EBITDA in the prior year comparative period. The Security Paper Products Segment generated operating EBITDA of $4.3 million in the six months ended June 30, 2017 compared to operating EBITDA of $6.5 million in the prior year comparative period. Corporate costs contributed to operating EBITDA loss of $4.3 million and $3.6 million in the six months ended June 30, 2017 and 2016, respectively. Corporate costs were higher mainly due to increased corporate and financing activities.

Adjusted net loss for the six months ended June 30, 2017, was $11.2 million or $0.78 per share basic and diluted. Adjusted net loss for the prior year comparative period was $19.1 million or $1.29 per share basic and diluted.

Manufacturing, product, freight and other distributions costs equaled $143.2 million, or 80.0% of sales, for the six months ended June 30, 2017, compared to $135.9 million, or 80.9% of sales, for the six months ended June 30, 2016.

SG&A expenses were $24.7 million for both of the six months ended June 30, 2017 and the prior year comparative period.

During the first six months of 2016, the Company completed the sale of the buildings, equipment, ancillary property, and energy generation and transmission plant located in Lebel-sur-Quévillon, Québec, which closed in July 2016. As a result of the sale, the Company recorded a $14.4 million reversal of the impairment taken during the fourth quarter of 2013.

Stock-based compensation was $0.4 million for the six months ended June 30, 2017 compared to $0.1 million in the prior year comparative period.

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

### Operating Results by Business Segment

*Dissolving Pulp Segment*

| | Six Months Ended | |
|---|---|---|
| (thousands of dollars, except for shipments, unaudited) | June 30, 2017 | June 30, 2016 |
| Sales | 91,498 | 82,581 |
| Operating loss | (977) | (6,114) |
| Amortization | 12,761 | 10,622 |
| Operating EBITDA | 11,784 | 4,508 |
| Dissolving Pulp Shipments (ADMT) | 72,505 | 71,693 |

Operating EBITDA for the first six months of 2017 at the FSC mill was $7.3 million higher relative to the prior year comparative period primarily due to overall improved dissolving pulp prices and higher production, with 73,674 ADMT of dissolving pulp produced in the six months ended June 30, 2017 compared to 70,154 ADMT of dissolving pulp produced in the six months ended June 30, 2016.

*Security Paper Products Segment*

| (thousands of dollars, except for shipments, unaudited) | June 30, 2017 | June 30, 2016 |
|---|---|---|
| Sales | 87,561 | 85,424 |
| Operating (loss) income | (598) | 1,582 |
| Non-recurring salary adjustment | 540 | - |
| Amortization | 4,347 | 4,932 |
| Operating EBITDA | 4,289 | 6,514 |
| Shipments (tonnes) | 5,975 | 5,369 |

During the year ended December 31, 2016, the Company completed the sale of its land and buildings relating to its security paper business in the security paper products segment for the aggregate purchase price of CHF 44.5 million. As a result of the sale and leaseback transaction, rent of $1.8 million was incurred in the first six months of

2017. Adjusting for rent, the results for the six-month period ended June 30, 2017 were slightly lower ($0.4 million) compared to the prior year comparative period due primarily to product mix.

**Selected Cash Flow Items**

| | Q2 2017 | Q1 2017 | Six Months Ended June 30, 2017 | Q2 2016 | Six Months Ended June 30, 2016 |
|---|---|---|---|---|---|
| **Cash flows from (used by) operating activities** | | | | | |
| Cash from operating activities before working capital changes | 4,385 | 8,084 | 12,469 | 6,675 | 8,197 |
| Non-cash working capital change | 4,859 | 7,347 | 12,206 | (3,079) | (5,593) |
| | 9,244 | 15,431 | 24,675 | 3,596 | 2,604 |
| **Cash flows (used by) from financing activities** | (3,550) | 11,337 | 7,787 | (8,311) | (8,785) |
| **Cash flows (used by) from investing activities** | | | | | |
| Additions to property, plant and equipment | (9,705) | (6,946) | (16,651) | (2,702) | (9,598) |
| Other | 8,845 | (1,680) | 7,165 | 2,799 | 9,630 |
| | (860) | (8,626) | (9,486) | 97 | 32 |
| **Change in cash position** | 4,834 | 18,142 | 22,976 | (4,618) | (6,149) |
| Foreign exchange loss on cash and cash equivalents | 77 | 179 | 256 | (657) | (1,497) |
| Cash and cash equivalents, beginning of period | 40,453 | 22,132 | 22,132 | 31,593 | 33,964 |
| **Cash and cash equivalents, end of period** | 45,364 | 40,453 | 45,364 | 26,318 | 26,318 |

***Operating Activities***

Fortress operates in a cyclical industry and its operating cash flows vary accordingly. Fortress' principal operating cash expenditures are for labour and raw materials. Operating activities provided cash of $24.7 million and provided $2.6 million in the six months ended June 30, 2017 and 2016, respectively. Working capital is subject to cyclical operating needs, the timing of collection of receivables and the payment of payables and expenses.

***Financing Activities***

During the first six months of 2017, financing activities provided cash of $7.8 million. Included in financing activities for the six months ended June 30, 2017, was the repayment of a $25.0 million unsecured convertible debenture. The Company also entered into an agreement with a new lender for a $40.0 million secured loan and made $1.6 million in long-term debt and $5.5 million in interest payments. Pursuant to the Company's normal course issuer bid for common shares (the "NCIB"), the Company repurchased 54,688 common shares for a total cost of $0.4 million at an average price of $6.58 per share during the second quarter of 2017. The Company has the ability to purchase an additional 355,321 common shares under the NCIB.

During the first six months of 2016, financing activities used cash of $8.8 million for the repayment of long term debt, interest payments and convertible debt repurchases under another normal course issuer bid.

***Investing Activities***

Investing activities in the first six months of 2017 used cash of $9.5 million. Investing activities relating to the purchase of equipment and other capital expenditures at the mills used cash of $16.7 million. Restricted cash provided cash of $2.3 million. The Company received $4.8 million in government grants relating to the fifth digester project.

Investing activities in the first six months of 2016 provided cash of $0.1 million. Investing activities relating to the purchase of equipment and other capital expenditures at the mills was $9.6 million. The Company received $3.2 million for the sale of marketable securities. Restricted cash, relating to cash security provided primarily for banknote contracts in the Security Paper Products Segment, provided $6.3 million in cash as performance bonds expired.

**Liquidity and Capital Resources**

As at June 30, 2017, the Company had a cash and cash equivalents balance of $45.4 million. Business maintenance capital expenditure was approximately $3.1 million in the quarter ended June 30, 2017. Project and/or discretionary capital expenditure for the quarter ended June 30, 2017 was approximately $2.1 million.

As at June 30, 2017, the Company had $13.1 million in restricted cash, a $4.3 million improvement from March 31, 2017. Included in the restricted cash balance was $4.9 million (CHF 3.6 million) rent and maintenance deposits as a result of the sale and leaseback transaction and $3.6 million deposit as a result of the IAM loan. The remaining balance is cash required for collateral on performance bonds.

At June 30, 2017, the Company's current portion of long-term debt, accounts payable and accrued liabilities totaled $57.1 million, all of which fall due for payment within one year of the statement of financial position date. If necessary, the Company has the ability to repay principal amounts outstanding, subject to receiving requisite approvals, of the remaining $62.1 million of convertible debentures due in 2019 in common shares of the Company. In February 2017, the Company repurchased in full the unsecured convertible debenture in the aggregate principal amount of $25.0 million in favour of Fonds de solidarité FTQ that was set to mature on June 20, 2017.

Corporate expenses in the second quarter of 2017 decreased by $0.3 to $2.0 million compared to the previous quarter.

Cash and restricted cash ended the second quarter at $58.5 million up from $37.1 million at the 2016 fiscal year end. Although there can be no assurances, Fortress believes that current cash, cash generated from operations, cashflow derived from improved working capital management, cash from the sale of assets alternative financing arrangements, and other cash generating initiatives, should be sufficient to meet its debt service, capital expenditure, short term working capital requirements, and investment activities external to the Company's current business segments. Fortress' future operating performance and its ability to finance capital expenditures, service its debt, repay its indebtedness upon maturity and pay other indebtedness will be subject to future economic conditions, the potential renegotiation or refinancing of existing indebtedness, the financial success of Fortress' business, Fortress' ability to successfully maximize margins and diversify product mix in response to changing market conditions, success of cost savings initiatives 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, foreign currency exchange rates and the duties imposed by China. No assurances are given as to the likelihood that the outcome of any such factors will be successful or will operate to positively impact the Company's business, operations and/or financial results.

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, refinance indebtedness, provide additional working capital, enhance liquidity or for other general corporate purposes.

In July 2016 the sale of the assets of the Fortress Global Cellulose mill was completed. The mill had previously been fully impaired for accounting purposes. Concurrent with the sale, the Company assigned and transferred a $7.0 million note issued by the purchaser to Investissement Québec ("IQ") as early repayment of principal amounts due in 2017 under the IQ loan. In addition, IQ has agreed to defer interest on the IQ loan until April 1, 2018 and to further defer an aggregate of $6.3 million of quarterly principal payments otherwise payable September 30, 2017, December 31, 2017, and March 31, 2018, without penalty or interest accruing on such amounts until the one year anniversary of each such principal payment due date. The remaining principal amount will be amortized in equal quarterly installments commencing June 30, 2018 over the remaining term of the loan.

Repayments of principal for debt outstanding as at June 30, 2017 are required as follows**:**

| | **($ 000's)** |
|---|---|
| 2017 | 2,343 |
| 2018 | 13,335 |
| 2019 | 77,254 |
| 2020 | 15,119 |
| 2021 | 14,841 |
| Thereafter | 84,646 |
| | 207,538 |

As at June 30, 2017, the Company had aggregate indebtedness of $211.9 million, including unamortized borrowing costs, and net working capital of $88.0 million.

*Commitments*

As at June 30, 2017, the Company has:

- committed to purchase steam from a supplier up to the end of 2025 for $1.2 million (CHF 0.9 million) per year;
- issued guaranteed letters of credit of $0.8 million relating to the continued delivery of power at our cogeneration facility and a performance security guarantee of up to $2.0 million for derivative financial instruments;
- committed to purchase $9.2 million in property, plant and equipment;
- guaranteed the secured note receivable transferred to a lender as early repayment of principal amounts due in 2017; and
- performance bonds in the amount of $25.0 million (EUR 16.9 million).

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

| | ($ 000's) |
|---|---|
| 2017 | 3,162 |
| 2018 | 4,394 |
| 2019 | 4,334 |
| 2020 | 4,099 |
| 2021 | 3,724 |
| Thereafter | 53,995 |
| | 73,708 |

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 continuously monitors the public and private debt markets and the public equity markets in order to ensure 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, United States dollar and euro.

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

| (thousands of dollars, unaudited) | June 30, 2017 $ | December 31, 2016 $ |
|---|---|---|
| Cash and cash equivalents | 45,364 | 22,132 |
| Less total debt | 211,943 | 197,780 |
| Net debt | (166,579) | (175,648) |
| Shareholders' equity | 210,193 | 210,549 |

The Company has certain financial covenants stipulating 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. 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 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 period ended June 30, 2017.

**Outstanding Shares**

The number of common shares outstanding at June 30, 2017, and the date of this report was 14,288,352. The number of options outstanding at June 30, 2017 and the date of this report was 655,458. At June 30, 2017 and the date of this report there were 88,345 restricted share units outstanding. At June 30, 2017 and the date of this report there were 262,178 and 267,814 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 into employment agreements. Further information is contained in our management information circulars in respect of our annual general meetings of shareholders, which are filed on SEDAR at www.sedar.com.

## Contingencies

Provisions for liabilities relating to legal actions, tax reassessments and claims require judgment using management's best estimates regarding projected outcomes and the range of loss, based on such factors as historical experiences, stage of proceedings and recommendations of legal counsel and tax advisors. Actual results may vary from estimates and the differences are recorded when known.

In a judgement made in March 2017, all legal claims filed against the Company in the Supreme Court of British Columbia brought by Sateri (Shanghai) Management Limited and Sateri International (Singapore) Pte. Ltd. (together, "Sateri") were dismissed and in June 2017, a notice of abandonment of an appeal was filed by Sateri concluding the legal proceedings.

In July 2017, a product claim in the Security Paper Products Segment dating back to July 2012 was dismissed by the courts and a $2.7 million reversal of a legal provision was recorded.

## Critical Accounting Estimates

For a review of significant management judgments affecting financial results and critical accounting estimates, see the Management's Discussion and Analysis for the year ended December 31, 2016 available on SEDAR.

## 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.

*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 the first interim period 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 or amendments or interpretations to existing standards issued but not yet effective which are expected to have a material impact on our consolidated financial statements.

**Risks and Uncertainties**

A comprehensive discussion of risk factors is included in the Company's Annual Information Form dated March 31, 2017, available on SEDAR at www.sedar.com. Those as well as risks detailed in the Management's Discussion and Analysis for the year ended December 31, 2016, also available on SEDAR, may impact the business of the Company.

**Disclosure Controls and Internal Controls over Financial Reporting**

During the quarter ended June 30, 2017, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.