MERCER INTERNATIONAL INC.
Form 10-Q
November 01, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2013

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File No.: 000-51826

MERCER INTERNATIONAL INC.

(Exact name of Registrant as specified in its charter)

Washington	**47-0956945**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

Suite 1120, 700 West Pender Street, Vancouver, British Columbia, Canada, V6C 1G8

(Address of office)

(604) 684-1099

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the *Securities Exchange Act of 1934* during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer	¨	Accelerated Filer	x
Non-Accelerated Filer	¨	Smaller Reporting Company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

The Registrant had 55,853,704 shares of common stock outstanding as at October 31, 2013.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2013

(Unaudited)

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands of Euros)

	September 30, 2013	December 31, 2012
ASSETS		
Current assets		
Cash and cash equivalents	134,168	104,239
Receivables	97,303	110,087
Inventories (Note 2)	122,604	118,300
Prepaid expenses and other	12,395	7,907
Deferred income tax	4,235	4,465
Total current assets	370,705	344,998
Long-term assets		
Property, plant and equipment	777,415	808,878
Deferred note issuance and other	14,138	12,162
Deferred income tax	14,226	17,565
	805,779	838,605
Total assets	1,176,484	1,183,603
LIABILITIES		
Current liabilities		
Accounts payable and other	103,155	89,950
Pension and other post-retirement benefit obligations (Note 4)	767	813
Debt (Note 3)	43,802	45,662
Total current liabilities	147,724	136,425
Long-term liabilities		
Debt (Note 3)	676,447	665,741
Unrealized interest rate derivative losses (Note 10)	36,759	50,678
Pension and other post-retirement benefit obligations (Note 4)	30,737	32,141
Capital leases and other	14,505	13,936
Deferred income tax	7,639	5,757
	766,087	768,253
Total liabilities	913,811	904,678

EQUITY		
Shareholders equity		
Share capital (Note 5)	248,923	248,371
Paid-in capital	(10,425)	(3,547)
Retained earnings	13,244	25,800
Accumulated other comprehensive income	18,630	25,181
Total shareholders equity	270,372	295,805
Noncontrolling interest (deficit) (Note 9)	(7,699)	(16,880)
Total equity	262,673	278,925
Total liabilities and equity	1,176,484	1,183,603

Commitments and contingencies (Note 12)

The accompanying notes are an integral part of these interim consolidated financial statements.

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands of Euros, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Revenues				
Pulp	186,100	205,122	559,879	590,597
Energy and chemicals	17,021	18,153	51,660	55,098
	203,121	223,275	611,539	645,695
Costs and expenses				
Operating costs	166,054	191,083	518,032	531,470
Operating depreciation and amortization	14,632	14,972	44,107	43,784
	22,435	17,220	49,400	70,441
Selling, general and administrative expenses	9,437	10,006	27,695	28,688
Restructuring expenses (Note 8)	2,926		2,926	
Operating income (loss)	10,072	7,214	18,779	41,753
Other income (expense)				
Interest expense	(13,018)	(14,084)	(39,305)	(42,080)
Gain (loss) on derivative instruments (Note 10)	1,978	(883)	12,091	1,336
Other income (expense)	172	517	108	(261)
Total other income (expense)	(10,868)	(14,450)	(27,106)	(41,005)
Income (loss) before income taxes	(796)	(7,236)	(8,327)	748
Income tax benefit (provision)				
Current	(1,057)	(870)	2,022	(7,207)
Deferred	115	(1,040)	(4,456)	2,300
Net income (loss)	(1,738)	(9,146)	(10,761)	(4,159)
Less: net income attributable to noncontrolling interest	(482)	(566)	(1,795)	(2,865)
Net income (loss) attributable to common shareholders	(2,220)	(9,712)	(12,556)	(7,024)
Net income (loss) per share attributable to common shareholders (Note 7)				
Basic and diluted	(0.04)	(0.17)	(0.23)	(0.13)

The accompanying notes are an integral part of these interim consolidated financial statements.

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MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands of Euros)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income (loss)	(1,738)	(9,146)	(10,761)	(4,159)
Other comprehensive income (loss), net of taxes				
Foreign currency translation adjustments (net of tax effects of (843), (328), (554), 197)	3,778	7,582	(7,453)	8,395
Change in unrecognized losses and prior service costs related to defined benefit plans (net of tax effects of nil in all periods)	268	(327)	920	(663)
Unrealized gains (losses) on marketable securities, arising during the period (net of tax effects of nil in all periods)	(1)	35	(18)	37
Other comprehensive income (loss), net of taxes	4,045	7,290	(6,551)	7,769
Total comprehensive income (loss)	2,307	(1,856)	(17,312)	3,610
Comprehensive income attributable to noncontrolling interest	(482)	(566)	(1,795)	(2,865)
Comprehensive income (loss) attributable to common shareholders	1,825	(2,422)	(19,107)	745

INTERIM CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

(Unaudited)

(In thousands of Euros)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income (loss) attributable to common shareholders	(2,220)	(9,712)	(12,556)	(7,024)
Retained earnings, beginning of period	15,464	40,673	25,800	37,985
Retained earnings, end of period	13,244	30,961	13,244	30,961

The accompanying notes are an integral part of these interim consolidated financial statements.

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QUARTERLY REPORT - PAGE 5

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands of Euros)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Cash flows from (used in) operating activities				
Net income (loss)	(1,738)	(9,146)	(10,761)	(4,159)
Adjustments to reconcile net income (loss) to cash flows from operating activities				
Unrealized loss (gain) on derivative instruments	(2,398)	883	(12,774)	(1,336)
Depreciation and amortization	14,694	15,054	44,298	43,992
Deferred income taxes	(115)	1,040	4,456	(2,300)
Stock compensation expense	621	891	1,194	1,753
Pension and other post-retirement expense, net of funding	124	(73)	457	(128)
Other	461	1,412	2,614	2,278
Changes in working capital				
Receivables	(696)	(14,122)	11,349	901
Inventories	(15,248)	5,834	(7,355)	9,276
Accounts payable and accrued expenses	9,061	9,692	18,088	13,146
Other	77	(2,239)	(6,413)	(901)
Net cash from (used in) operating activities	4,843	9,226	45,153	62,522
Cash flows from (used in) investing activities				
Purchase of property, plant and equipment	(6,991)	(9,152)	(29,368)	(27,455)
Proceeds on sale of property, plant and equipment	233	48	248	387
Proceeds on maturity of marketable securities		10,213		12,221
Net cash from (used in) investing activities	(6,758)	1,109	(29,120)	(14,847)
Cash flows from (used in) financing activities				
Repayment of debt and purchase of notes	(22,174)	(15,544)	(42,719)	(27,254)
Proceeds from issuance of notes and borrowings of debt	39,607		56,607	
Repayment of capital lease obligations	(396)	(508)	(1,497)	(1,567)
Proceeds from (repayment of) credit facilities, net	(12,226)		728	
Payment of note issuance costs	(1,794)		(1,794)	(1,621)
Proceeds from government grants		778	4,147	3,100
Net cash from (used in) financing activities	3,017	(15,274)	15,472	(27,342)
Effect of exchange rate changes on cash and cash equivalents	(1,367)	221	(1,576)	764

Net increase (decrease) in cash and cash equivalents	(265)	(4,718)	29,929	21,097
Cash and cash equivalents, beginning of period	134,433	130,887	104,239	105,072
Cash and cash equivalents, end of period	134,168	126,169	134,168	126,169

The accompanying notes are an integral part of these interim consolidated financial statements.

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Unaudited)

(In thousands of Euros)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Supplemental disclosure of cash flow information				
Cash paid during the period for				
Interest	2,370	3,820	26,833	30,086
Income taxes	1,972	370	3,500	3,389
Supplemental schedule of non-cash investing and financing activities				
Acquisition of production and other equipment under capital lease obligations	803	(186)	1,218	588
Increase (decrease) in accounts payable and accrued purchases for property, plant and equipment	(1,418)	1,472	(3,860)	3,375
Increase (decrease) in receivables of government grants for long-term assets		(200)		(2,533)

The accompanying notes are an integral part of these interim consolidated financial statements.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 1. The Company and Summary of Significant Accounting Policies

Basis of Presentation

The interim consolidated financial statements contained herein include the accounts of Mercer International Inc. (Mercer Inc.) and its wholly-owned and majority-owned subsidiaries (collectively the Company). The Company s shares of common stock are quoted and listed for trading on both the NASDAQ Global Market and the Toronto Stock Exchange.

The interim consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC). The year-end Consolidated Balance Sheet data was derived from audited financial statements. The footnote disclosure included herein has been prepared in accordance with accounting principles generally accepted for interim financial statements in the United States (GAAP). The interim consolidated financial statements should be read together with the audited consolidated financial statements and accompanying notes included in the Company s latest annual report on Form 10-K for the fiscal year ended December 31, 2012. In the opinion of the Company, the unaudited interim consolidated financial statements contained herein contain all adjustments necessary for a fair statement of the results of the interim periods included. The results for the periods included herein may not be indicative of the results for the entire year.

The Company has three pulp mills that are aggregated into one reportable business segment, market pulp. Accordingly, the results presented are those of the reportable business segment.

In these interim consolidated financial statements, unless otherwise indicated, all amounts are expressed in Euros ( ). The term U.S. dollars and the symbol $ refer to United States dollars. The symbol C$ refers to Canadian dollars.

Use of Estimates

Preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant management judgment is required in determining the accounting for, among other things, doubtful accounts and reserves, depreciation and amortization, future cash flows associated with impairment testing for long-lived assets, derivative financial instruments, environmental conservation and legal liabilities, asset retirement obligations, pensions and post-retirement benefit obligations, income taxes, contingencies, and inventory obsolescence and provisions. Actual results could differ materially from these estimates, and changes in these estimates are recorded when known.

Note 2. Inventories

	September 30, 2013	December 31, 2012

Raw materials	47,769	46,028
Finished goods	36,991	38,169
Spare parts and other	37,844	34,103
	122,604	118,300

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 3. Debt

Debt consists of the following:

	September 30, 2013	December 31, 2012
Note payable to bank, included in a total loan credit facility of 827,950 to finance the construction related to the Stendal mill (a)	412,907	452,907
Senior notes, interest at 9.50% accrued and payable semi-annually, unsecured (b)	248,642	215,670
Credit agreement with a lender with respect to a revolving credit facility of C$40.0 million (c)	5,029	4,574
Term bank facility for a project at the Stendal mill of 17,000 (d)	15,370	
Loans payable to the noncontrolling shareholder of the Stendal mill (e)	37,757	36,620
Investment loan agreement with a lender with respect to a project at the Rosenthal mill of 4,351 (f)	544	1,632
Credit agreement with a bank with respect to a revolving credit facility of 25,000 (g)		
Credit agreement with a bank with respect to a revolving credit facility of 5,000 (h)		
	720,249	711,403
Less: current portion	(43,802)	(45,662)
Debt, less current portion	676,447	665,741

As of September 30, 2013, the maturities of debt are as follows:

Matures	Amount
2013	
2014	43,802
2015	47,584
2016	52,613

2017	576,250
Thereafter	
	720,249

Certain of the Company s debt instruments were issued under an indenture which, among other things, restricts its ability and the ability of its restricted subsidiaries to make certain payments. These limitations are subject to specific exceptions. As at September 30, 2013, the Company was in compliance with the terms of the indenture.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 3. Debt (continued)

(a) Note payable to bank, included in a total loan facility of 827,950 to finance the construction related to the Stendal mill (Stendal Loan Facility), interest at rates varying from Euribor plus 0.90% to Euribor plus 1.80% (rates on amounts of borrowing at September 30, 2013 range from 1.39% to 2.14%), principal due in required installments beginning September 30, 2006 until September 30, 2017, collateralized by the gross assets of the Stendal mill, with 48% and 32% guaranteed by the Federal Republic of Germany and the State of Saxony-Anhalt, respectively, of up to 352,907 of outstanding principal, subject to a debt service reserve account (DSRA) for purposes of paying amounts due in the following 12 months under the terms of the Stendal Loan Facility; payment of dividends is only permitted if certain cash flow requirements are met. See Note 10 Derivative Transactions for a discussion of the Company s variable-to-fixed interest rate swap that was put in place to effectively fix the interest rate on the Stendal Loan Facility.

On March 13, 2009, the Company finalized an agreement with its lenders to amend its Stendal Loan Facility. The amendment deferred approximately 164,000 of scheduled principal payments until the maturity date, September 30, 2017. The amendment also provided for a 100% cash sweep, referred to as the Cash Sweep , of any cash, in excess of a 15,000 working capital reserve, the Guarantee Amount, as discussed in Note 12(a) Commitments and Contingencies, and other amounts as contemplated in the amendment, held by Stendal which will be used first to fund the DSRA to a level sufficient to service the amounts due and payable under the Stendal Loan Facility during the then following 12 months, which means the DSRA is Fully Funded , and second to prepay the deferred principal amounts. As at September 30, 2013, the DSRA balance was 32,996 and was not Fully Funded.

On September 30, 2013, the Company amended the terms of the Stendal Loan Facility and Project Blue Mill facility (the Facilities) (Note 3(d)). The amendment included waiving compliance with the annual debt service cover ratio and the senior debt cover ratio under the Facilities until and including December 31, 2013; amending the senior debt cover ratio so that it now deducts the DSRA and other specified cash above a stipulated threshold in the calculation of senior debt; providing that a failure to satisfy the annual debt service cover ratio under the Facilities would only be an event of default when amounts in the DSRA plus certain cash reserves are below a specified threshold; and revising the calculation of amounts required to cure a senior debt cover ratio default. Pursuant to the amended agreement the Company made a capital investment of $20.0 million in Stendal. See Note 9 Noncontrolling Interest for details of the investment.

(b) On November 17, 2010, the Company completed a private offering of $300.0 million in aggregate principal amount of senior notes due 2017 (Senior Notes). The Senior Notes were issued at a price of 100% of their principal amount. The Senior Notes will mature on December 1, 2017 and bear interest at 9.50% which is accrued and payable semi-annually.

In July 2013, the Company issued $50.0 million in aggregate principal amount of its Senior Notes. The additional notes were priced at 104.50% plus accrued interest from June 1, 2013. The net proceeds from the offering were $50.5 million, after deducting the underwriter s discounts, offering expenses and accrued interest. The Company used the net proceeds from the offering to repay the revolving credit facilities of the Rosenthal and Celgar mills and for general corporate purposes.

In June 2012, the Company s Board of Directors authorized the purchase of up to 50,000 in aggregate principal amount of the Company s Senior Notes from time to time, over a period ended June 2013. During the six month period ended June 30, 2013, the Company did not purchase any of its outstanding Senior Notes. During the twelve month period ended December 31, 2012, the Company purchased $2.0 million of its outstanding Senior Notes.

The Senior Notes are general unsecured senior obligations of the Company. The Senior Notes rank equal in right of payment with all existing and future senior unsecured indebtedness of the Company and senior in right of payment to any current or future subordinated indebtedness of the Company. The Senior Notes are effectively junior in right of payment to all borrowings of the Company s restricted subsidiaries, including borrowings under the Company s credit agreements which are secured by certain assets of its restricted subsidiaries.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 3. Debt (continued)

The Company may redeem all or a part of the Senior Notes, upon not less than 30 days or more than 60 days notice, at the redemption prices (expressed as percentages of principal amount) equal to 104.75% for the twelve month period beginning on December 1, 2014, 102.38% for the twelve month period beginning on December 1, 2015, and 100.00% beginning on December 1, 2016 and at any time thereafter, plus accrued and unpaid interest.

(c) Credit agreement with respect to a revolving credit facility of up to C$40.0 million for the Celgar mill. The credit facility matures May 2016. Borrowings under the credit facility are collateralized by the mill s inventory and receivables and are restricted by a borrowing base calculated on the mill s inventory and receivables. Canadian dollar denominated amounts bear interest at bankers acceptance plus 1.75% or Canadian prime plus 0.25%. U.S. dollar denominated amounts bear interest at LIBOR plus 1.75% or U.S. base plus 0.25%. As at September 30, 2013, this facility was accruing interest at a rate of approximately 2.97%, C$7.0 million of this facility was drawn, C$1.7 million of this facility was supporting letters of credit and approximately C$21.4 million was available.

(d) A 17,000 amortizing term facility to partially finance a project, referred to as Project Blue Mill , which is expected to increase the Stendal mill s annual pulp production capacity by 30,000 air-dried metric tonnes and includes the installation of an additional 40 megawatt steam turbine. The facility, 80% of which is guaranteed by the State of Saxony-Anhalt, bears interest at a rate of Euribor plus 3.5% per annum. The interest period for the facility, at the choice of the Company, will be of one, three or six months duration and interest is paid on the last day of the interest period selected. The facility, together with accrued interest, is scheduled to mature in September 2017. The facility will be repaid semi-annually, commencing September 30, 2013, is collateralized by the gross assets of the Stendal mill, and will be non-recourse to the Company. As at September 30, 2013, the facility was accruing interest at a rate of approximately 3.84%.

As part of this term facility, the Company was required to open an investment account with the lender for the purpose of managing project costs and is required to deposit all funding associated with Project Blue Mill in this account. As at September 30, 2013, the balance in the investment account was 1,339.

(e) Loans of 26,760 payable by the Stendal mill to its noncontrolling shareholder bear interest at a rate of 1.00% per annum and are due in 2017, provided that the Project Blue Mill facility (Note 3(d)) and the Stendal Loan Facility (Note 3(a)) have been fully repaid on such date. The loans are unsecured, subordinated to all liabilities of the Stendal mill, non-recourse to the Company and its restricted subsidiaries. One of the loans, which has a principal amount of 440, may be repaid prior to October 1, 2017 if the DSRA has been Fully Funded for the first time and this loan is subordinated to all liabilities of the Stendal mill only until such time as the DSRA is Fully Funded for the first time.

As at September 30, 2013, accrued interest on these loans was 10,997. As at December 31, 2012, accrued interest on these loans was 9,860.

(f) A four-year amortizing investment loan agreement with a lender relating to the wash press project at the Rosenthal mill with a total facility of 4,351 bearing interest at the rate of Euribor plus 2.75% that matures February 2014. Borrowings under this agreement are secured by the wash press equipment. As at September 30, 2013, the balance outstanding was 544 and was accruing interest at a rate of 3.09%.

(g) A 25,000 working capital facility at the Rosenthal mill that matures in October 2016. Borrowings under the facility are collateralized by the mill s inventory and receivables and bear interest at Euribor plus 3.50%. As at September 30, 2013, approximately 600 of this facility was supporting bank guarantees leaving approximately 24,400 available.

(h) A 5,000 facility at the Rosenthal mill that matures in December 2015. Borrowings under this facility bear interest at the rate of the three-month Euribor plus 3.50% and are secured by certain land at the Rosenthal mill. As at September 30, 2013, approximately 1,100 of this facility was supporting bank guarantees leaving approximately 3,900 available.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 4. Pension and Other Post-Retirement Benefit Obligations

Included in pension and other post-retirement benefit obligations are amounts related to the Company s Celgar and Rosenthal mills. The largest component of this obligation is with respect to the Celgar mill which maintains a defined benefit pension plan and post-retirement benefit plans for certain employees (Celgar Plans).

Pension benefits are based on employees earnings and years of service. The Celgar Plans are funded by contributions from the Company based on actuarial estimates and statutory requirements. Pension contributions during the three and nine month periods ended September 30, 2013 totaled 471 and 1,373, respectively (2012 481 and 1,493).

Effective December 31, 2008, the defined benefit plan was closed to new members. In addition, the defined benefit service accrual ceased on December 31, 2008, and members began to receive pension benefits, at a fixed contractual rate, under a new defined contribution plan effective January 1, 2009. During the three and nine month periods ended September 30, 2013, the Company made contributions of 148 and 439, respectively (2012 142 and 462) to this plan.

Information about the Celgar Plans, in aggregate for the three and nine month periods ended September 30, 2013 and September 30, 2012 is as follows:

	Three Months ended September 30,			
	2013		2012	
	Pension Benefits	Post-Retirement Benefits	Pension Benefits	Post-Retirement Benefits
Service cost	25	141	29	145
Interest cost	344	208	393	226
Expected return on plan assets	(399)		(421)	
Recognized net loss	269	22	291	1
Net periodic benefit cost	239	371	292	372

	Nine Months ended September 30,			
	2013		2012	
	Pension Benefits	Post-Retirement Benefits	Pension Benefits	Post-Retirement Benefits
Service cost	78	432	84	423

Interest cost	1,052	635	1,144	657
Expected return on plan assets	(1,222)		(1,228)	
Recognized net loss	824	67	848	4
Net periodic benefit cost	732	1,134	848	1,084

The Company participates in a multiemployer plan for hourly-paid employees at the Celgar mill. The contributions to this plan are determined based on an amount per hour worked pursuant to a collective bargaining agreement. The Company has no current or future contribution obligations in excess of the contractual contributions. During the three and nine month periods ended September 30, 2013, the Company made contributions of 369 and 1,130, respectively (2012 632 and 1,572) to this plan.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 5. Share Capital

Common shares

The Company has authorized 200,000,000 common shares with a par value of $1 per share.

As at September 30, 2013, the Company had 55,853,704 common shares issued and outstanding. As at December 31, 2012, the Company had 55,815,704 common shares issued and outstanding. During the nine months ended September 30, 2013, the Company issued 38,000 restricted shares to directors of the Company.

Preferred shares

The Company has authorized 50,000,000 preferred shares with $1 par value issuable in series, of which 2,000,000 shares have been designated as Series A. The preferred shares may be issued in one or more series and with such designations and preferences for each series as shall be stated in the resolutions providing for the designation and issue of each such series adopted by the Board of Directors of the Company. The Board of Directors is authorized by the Company s articles of incorporation to determine the voting, dividend, redemption and liquidation preferences pertaining to each such series. As at September 30, 2013, no preferred shares had been issued by the Company.

Note 6. Stock-Based Compensation

The Company has a stock incentive plan (the 2010 Plan) which provides for options, restricted stock rights, restricted shares, performance shares, performance share units (PSUs) and stock appreciation rights to be awarded to employees, consultants and non-employee directors. As at September 30, 2013, after factoring in all allocated shares, there remain approximately 1.1 million common shares available for grant pursuant to the 2010 Plan.

During the nine month period ended September 30, 2013 there were no changes to the issued and outstanding restricted stock rights, performance shares, or stock appreciation rights. In September 2013, 100,000 options expired leaving 75,000 outstanding as at September 30, 2013.

The following table summarizes PSU activity during the period:

	Number of PSUs
Outstanding at January 1, 2012	795,312
Granted	55,478
Forfeited	(64,661)
Outstanding at December 31, 2012	786,129

Granted	35,810
Outstanding at September 30, 2013	821,939

The following table summarizes restricted share activity during the period:

	Number of Restricted Shares
Outstanding at January 1, 2012	238,000
Granted	36,500
Vested	(78,000)
Outstanding at December 31, 2012	196,500
Granted	38,000
Vested	(76,500)
Outstanding at September 30, 2013	158,000

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 7. Net Income (Loss) Per Share Attributable to Common Shareholders

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Net income (loss) attributable to common shareholders:				
Basic and diluted	(2,220)	(9,712)	(12,556)	(7,024)
Net income (loss) per share attributable to common shareholders:				
Basic and diluted	(0.04)	(0.17)	(0.23)	(0.13)
Weighted average number of common shares outstanding:				
Basic and diluted [(1)]	55,695,704	55,619,204	55,666,470	55,589,226

(1) The weighted average number of shares excludes 158,000 restricted shares which have been issued, but have not vested as at September 30, 2013 (2012 196,500 restricted shares).

The calculation of diluted net income (loss) per share attributable to common shareholders does not assume the exercise of any instruments that would have an anti-dilutive effect on net income (loss) per share. The following table summarizes the instruments excluded from the calculation of net income (loss) per share attributable to common shareholders because they were anti-dilutive.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
PSUs	821,939	767,979	821,939	767,979
Restricted shares	158,000	196,500	158,000	196,500
Stock options	75,000	175,000	75,000	175,000

Note 8. Restructuring Expenses

In July 2013, the Company announced a workforce reduction at the Celgar mill. The planned reduction will affect both hourly and salaried employees and will reduce the workforce by approximately 85 employees over the next five years, with the majority of employees to be affected over the next nine months. In connection with implementing this workforce reduction, the Company currently estimates that it will incur pre-tax charges in the range of approximately 4,400 to 5,900 for severance and other personnel expenses, such as termination benefits, which are expected to occur primarily over the 12-month period commencing with the third quarter of 2013. During the three months ended September 30, 2013, the Company recorded restructuring expenses of 2,926 and as at September 30, 2013, the Company had a liability of 2,545 in accounts payable and other.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 9. Noncontrolling Interest

The following table provides a reconciliation of the carrying amount of deficit attributable to the noncontrolling shareholders interest in the Stendal mill:

Balance at January 1, 2012	18,574
Net income	(1,694)
Balance at December 31, 2012	16,880
Net income	(1,795)
Capital contribution	(7,386)
Balance at September 30, 2013	7,699

In September 2013, the Company made a $20.0 million (14,809) capital investment in the Stendal mill, resulting in an 8.1% increase in the Company s equity ownership in the mill as it went from 74.9% to 83.0%. The increase in equity ownership was accounted for as an equity transaction and as a result, the noncontrolling deficit was reduced by 7,386, and the paid-in capital, which includes legal fees associated with the transaction, was reduced by 7,478.

Note 10. Derivative Transactions

The Company is exposed to certain market risks relating to its ongoing business. The Company seeks to manage these risks through internal risk management policies as well as, from time to time, the use of derivatives. The Company currently manages its interest rate risk and a small portion of its pulp sales price risk with the use of derivative instruments. The derivatives are measured at fair value with changes in fair value immediately recognized in gain (loss) on derivative instruments in the Interim Consolidated Statement of Operations.

Derivative assets are presented in prepaid expenses and other, current derivative liabilities are presented in accounts payable and other and long-term derivative liabilities are presented in unrealized interest rate derivative losses in the Interim Consolidated Balance Sheet.

Interest Rate Derivative

During 2004, the Company entered into certain variable-to-fixed interest rate swaps in connection with the Stendal mill with respect to an aggregate maximum amount of approximately 612,600 of the principal amount of the indebtedness under the Stendal Loan Facility. Under the remaining interest rate swap, the Company pays a fixed rate and receives a floating rate with the interest payments being calculated on a notional amount. As at September 30, 2013, the contract has an aggregate notional amount of 332,684 at a fixed interest rate of 5.28% and it matures in

October 2017 (which for the most part matches the maturity of the Stendal Loan Facility).

The interest rate derivative contract is with a bank that is part of a banking syndicate that holds the Stendal Loan Facility and the Company does not anticipate non-performance by the bank.

Pulp Price Derivatives

In May 2012, the Company entered into a fixed price pulp swap contract with a bank. Under the terms of the contract, 5,000 metric tonnes (MT) of pulp per month was fixed at a price of $915 per MT. The contract expired in December 2012. In November 2012, the Company entered into two additional contracts. Under the terms of the contracts, 3,000 MT of pulp per month is fixed at prices which range from $880 to $890 per MT. These contracts expire in December 2013.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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(In thousands of Euros, except per share data)

Note 10. Derivative Transactions (continued)

The following table shows the derivative gains and losses by instrument type as they are recognized in gain (loss) on derivative instruments in the Interim Consolidated Statement of Operations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Interest rate derivative contract	3,038	(1,236)	13,918	(636)
Pulp price derivative contracts	(1,060)	353	(1,827)	1,972
	1,978	(883)	12,091	1,336

Note 11. Financial Instruments

The fair value of financial instruments is summarized as follows:

	September 30, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	134,168	134,168	104,239	104,239
Marketable securities	163	163	184	184
Receivables	97,303	97,303	110,087	110,087
Pulp price derivative contracts asset			745	745
Accounts payable and other excluding derivatives	102,767	102,767	89,950	89,950
Pulp price derivative contracts liability	388	388		
Debt	720,249	712,490	711,403	700,001
Interest rate derivative contract liability	36,759	36,759	50,678	50,678

The carrying value of cash and cash equivalents and accounts payable and other approximates the fair value due to the immediate or short-term maturity of these financial instruments. The carrying value of receivables approximates the fair value due to their short-term nature and historical collectability. Marketable securities are recorded at fair value based on recent transactions. See the Fair Value Measurement and Disclosure section below for details on how the fair value of the pulp price derivative contracts, interest rate derivative contract and debt was determined.

Fair Value Measurement and Disclosure

The fair value methodologies and, as a result, the fair value of the Company s marketable securities, debt and derivative instruments are determined based on the fair value hierarchy provided in the Fair Value Measurements and Disclosures topic of the FASB Accounting Standards Codification, and are as follows:

Level 1 Valuations based on quoted prices in active markets for *identical* assets and liabilities.

Level 2 Valuations based on observable inputs in active markets for *similar* assets and liabilities, other than Level 1 prices, such as quoted commodity prices or interest or currency exchange rates.

Level 3 Valuations based on significant unobservable inputs that are supported by little or no market activity, such as discounted cash flow methodologies based on internal cash flow forecasts.

The Company classified its marketable securities within Level 1 of the valuation hierarchy because quoted prices are available in an active market for the exchange-traded equities.

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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(In thousands of Euros, except per share data)

Note 11. Financial Instruments (continued)

The Company s interest rate and pulp price derivatives are classified within Level 2 of the valuation hierarchy, as they are valued using internal models that use as their basis readily observable market inputs, such as forward interest rates, yield curves observable at specified intervals and commodity price curves. The observable inputs reflect market data obtained from independent sources. In addition, the Company considered the risk of non-performance of the obligor, which in some cases reflects the Company s own credit risk. The counterparty to our interest rate and pulp price derivatives are multi-national financial institutions.

The Company s debt is recognized at amortized cost. The fair value of debt classified as Level 2 reflects recent market transactions and discounted cash flow estimates. Discounted cash flow models use observable market inputs taking into consideration variables such as interest rate changes, comparative securities, subordination discount and credit rating changes. The fair value of debt classified as Level 3 is valued using a discounted cash flow model which requires significant management estimates. These estimates are developed using available market, historical, and forecast data, including taking into account variables such as recent financing activities, the capital structure, and the lack of marketability of such debt.

The following table presents a summary of the Company s outstanding financial instruments and their estimated fair values under the hierarchy defined in Fair Value Measurements and Disclosures Topic of the FASB Accounting Standards Codification:

	Fair Value Measurements at September 30, 2013			
Description	Level 1	Level 2	Level 3	Total
Assets				
Marketable securities	163			163
Liabilities				
Pulp price derivative contracts		388		388
Interest rate derivative contract		36,759		36,759
Debt		699,275	13,215	712,490
		736,422	13,215	749,637

Description	Fair Value Measurements at December 31, 2012			
	Level 1	Level 2	Level 3	Total
Assets				
Marketable securities	184			184
Pulp price derivative contracts		745		745
	184	745		929
Liabilities				
Interest rate derivative contract		50,678		50,678
Debt		687,184	12,817	700,001
		737,862	12,817	750,679

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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(In thousands of Euros, except per share data)

Note 12. Commitments and Contingencies

(a) Pursuant to an arbitration proceeding with the general construction contractor (the noncontrolling shareholder) of the Stendal mill regarding certain warranty claims, the Company acted upon a bank guarantee for defect liability on civil works that was about to expire as provided in the engineering, procurement, and construction contract. On January 28, 2011, the Company received approximately 10,000 (the Guarantee Amount), which is intended to compensate the Company for remediation work that is required at the Stendal mill, but it was less than the amount claimed by the Company under the arbitration. Most of the claims have been settled; however, the arbitration proceeding is ongoing, and there is no certainty that the Company will be successful with its remaining claim.

The 10,000 was initially recognized as an increase in cash and a corresponding increase in accounts payable and other. As civil works remediation steps are agreed to with the noncontrolling shareholder an agreed to portion of the payable is reversed with the offset recorded in operating costs to offset the remediation expenditures. As at September 30, 2013, the Company had Guarantee Amount proceeds of 1,768 remaining in accounts payable and other.

(b) The Company is involved in a property transfer tax dispute with respect to the Celgar mill and certain other legal actions and claims arising in the ordinary course of business. Celgar had previously paid the property transfer tax assessment. During the second quarter of 2013, the Company lost its Supreme Court of British Columbia appeal of the property transfer tax assessment and as a result the Company filed an application to seek leave to appeal to the British Columbia Court of Appeal. In September 2013, the leave to appeal was granted to the Company. In addition, while the outcome of any legal actions and claims cannot be predicted with certainty, it is the opinion of management that the outcome of any such claim which is pending or threatened, either individually or on a combined basis, will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company.

(c) The Company is subject to regulations that require the handling and disposal of asbestos in a prescribed manner if a property undergoes a major renovation or demolition. Otherwise, the Company is not required to remove asbestos from its facilities. Generally asbestos is found on steam and condensate piping systems as well as certain cladding on buildings and in building insulation throughout older facilities. The Company s obligation for the proper removal and disposal of asbestos products from the Company s mills is a conditional asset retirement obligation. As a result of the longevity of the Company s mills, due in part to the maintenance procedures and the fact that the Company does not have plans for major changes that require the removal of asbestos, the timing of the asbestos removal is indeterminate. As a result, the Company is currently unable to reasonably estimate the fair value of its asbestos removal and disposal obligation. The Company will recognize a liability in the period in which sufficient information is available to reasonably estimate its fair value.

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 13. Restricted Group Supplemental Disclosure

The terms of the indenture governing our Senior Notes require that we provide the results of operations and financial condition of Mercer International Inc. and our restricted subsidiaries under the indenture, collectively referred to as the Restricted Group . As at and during the three and nine months ended September 30, 2013 and 2012, the Restricted Group was comprised of Mercer International Inc., certain holding subsidiaries and our Rosenthal and Celgar mills. The Restricted Group excludes the Stendal mill.

Combined Condensed Balance Sheets

	September 30, 2013			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
ASSETS				
Current assets				
Cash and cash equivalents	75,075	59,093		134,168
Receivables	52,595	44,708		97,303
Inventories	68,731	53,873		122,604
Prepaid expenses and other	7,977	4,418		12,395
Deferred income tax	2,219	2,016		4,235
Total current assets	206,597	164,108		370,705
Long-term assets				
Property, plant and equipment	318,865	458,550		777,415
Deferred note issuance and other	7,525	6,613		14,138
Deferred income tax	8,726	5,500		14,226
Due from unrestricted group	109,399		(109,399)	
Total assets	651,112	634,771	(109,399)	1,176,484
LIABILITIES				
Current liabilities				
Accounts payable and other	51,865	51,290		103,155
Pension and other post-retirement benefit obligations	767			767
Debt	544	43,258		43,802
Total current liabilities	53,176	94,548		147,724
Long-term liabilities				

Debt	253,671	422,776		676,447
Due to restricted group		109,399	(109,399)	
Unrealized interest rate derivative losses		36,759		36,759
Pension and other post-retirement benefit obligations	30,737			30,737
Capital leases and other	6,167	8,338		14,505
Deferred income tax	7,639			7,639
Total liabilities	351,390	671,820	(109,399)	913,811
EQUITY				
Total shareholders equity (deficit)	299,722	(29,350)		270,372
Noncontrolling interest (deficit)		(7,699)		(7,699)
Total liabilities and equity	651,112	634,771	(109,399)	1,176,484

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 13. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Balance Sheets

	December 31, 2012			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
ASSETS				
Current assets				
Cash and cash equivalents	36,714	67,525		104,239
Receivables	61,212	48,875		110,087
Inventories	74,786	43,514		118,300
Prepaid expenses and other	5,811	2,096		7,907
Deferred income tax	2,188	2,277		4,465
Total current assets	180,711	164,287		344,998
Long-term assets				
Property, plant and equipment	345,311	463,567		808,878
Deferred note issuance and other	6,607	5,555		12,162
Deferred income tax	9,179	8,386		17,565
Due from unrestricted group	102,311		(102,311)	
Total assets	644,119	641,795	(102,311)	1,183,603
LIABILITIES				
Current liabilities				
Accounts payable and other	42,106	47,844		89,950
Pension and other post-retirement benefit obligations	813			813
Debt	5,662	40,000		45,662
Total current liabilities	48,581	87,844		136,425
Long-term liabilities				
Debt	216,214	449,527		665,741
Due to restricted group		102,311	(102,311)	
Unrealized interest rate derivative losses		50,678		50,678
Pension and other post-retirement benefit obligations	32,141			32,141

Capital leases and other	6,073	7,863		13,936
Deferred income tax	5,757			5,757
Total liabilities	308,766	698,223	(102,311)	904,678
EQUITY				
Total shareholders equity (deficit)	335,353	(39,548)		295,805
Noncontrolling interest (deficit)		(16,880)		(16,880)
Total liabilities and equity	644,119	641,795	(102,311)	1,183,603

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(In thousands of Euros, except per share data)

Note 13. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Statements of Operations

	Three Months Ended September 30, 2013			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	105,794	80,306		186,100
Energy and chemicals	5,935	11,086		17,021
	111,729	91,392		203,121
Operating costs	90,815	75,239		166,054
Operating depreciation and amortization	8,130	6,502		14,632
Selling, general and administrative expenses	5,608	3,829		9,437
Restructuring expenses	2,926			2,926
	107,479	85,570		193,049
Operating income (loss)	4,250	5,822		10,072
Other income (expense)				
Interest expense	(6,193)	(8,472)	1,647	(13,018)
Gain (loss) on derivative instruments	(1,060)	3,038		1,978
Other income (expense)	1,791	28	(1,647)	172
Total other income (expense)	(5,462)	(5,406)		(10,868)
Income (loss) before income taxes	(1,212)	416		(796)
Income tax benefit (provision)	(1,087)	145		(942)
Net income (loss)	(2,299)	561		(1,738)
Less: net income attributable to noncontrolling interest		(482)		(482)
	(2,299)	79		(2,220)

Net income (loss) attributable to common shareholders

	Three Months Ended September 30, 2012			
	Restricted Group	**Unrestricted Subsidiaries**	**Eliminations**	**Consolidated Group**
Revenues				
Pulp	112,777	92,345		205,122
Energy and chemicals	6,960	11,193		18,153
	119,737	103,538		223,275
Operating costs	109,815	81,268		191,083
Operating depreciation and amortization	8,303	6,669		14,972
Selling, general and administrative expenses	6,392	3,614		10,006
	124,510	91,551		216,061
Operating income (loss)	(4,773)	11,987		7,214
Other income (expense)				
Interest expense	(6,010)	(9,473)	1,399	(14,084)
Gain (loss) on derivative instruments	353	(1,236)		(883)
Other income (expense)	1,665	251	(1,399)	517
Total other income (expense)	(3,992)	(10,458)		(14,450)
Income (loss) before income taxes	(8,765)	1,529		(7,236)
Income tax benefit (provision)	(1,192)	(718)		(1,910)
Net income (loss)	(9,957)	811		(9,146)
Less: net income attributable to noncontrolling interest		(566)		(566)
Net income (loss) attributable to common shareholders	(9,957)	245		(9,712)

MERCER INTERNATIONAL INC.

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(Unaudited)

(In thousands of Euros, except per share data)

Note 13. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Statements of Operations

	Nine Months Ended September 30, 2013			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	311,575	248,304		559,879
Energy and chemicals	19,065	32,595		51,660
	330,640	280,899		611,539
Operating costs	283,896	234,136		518,032
Operating depreciation and amortization	24,579	19,528		44,107
Selling, general and administrative expenses	16,968	10,727		27,695
Restructuring expenses	2,926			2,926
	328,369	264,391		592,760
Operating income (loss)	2,271	16,508		18,779
Other income (expense)				
Interest expense	(17,939)	(26,309)	4,943	(39,305)
Gain (loss) on derivative instruments	(1,827)	13,918		12,091
Other income (expense)	4,946	105	(4,943)	108
Total other income (expense)	(14,820)	(12,286)		(27,106)
Income (loss) before income taxes	(12,549)	4,222		(8,327)
Income tax benefit (provision)	(2,714)	280		(2,434)
Net income (loss)	(15,263)	4,502		(10,761)
Less: net income attributable to noncontrolling interest		(1,795)		(1,795)
Net income (loss) attributable to common shareholders	(15,263)	2,707		(12,556)

	Nine Months Ended September 30, 2012			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	326,411	264,186		590,597
Energy and chemicals	21,411	33,687		55,098
	347,822	297,873		645,695
Operating costs	302,913	228,557		531,470
Operating depreciation and amortization	23,750	20,034		43,784
Selling, general and administrative expenses	18,319	10,369		28,688
	344,982	258,960		603,942
Operating income (loss)	2,840	38,913		41,753
Other income (expense)				
Interest expense	(17,754)	(28,449)	4,123	(42,080)
Gain (loss) on derivative instruments	1,972	(636)		1,336
Other income (expense)	3,405	457	(4,123)	(261)
Total other income (expense)	(12,377)	(28,628)		(41,005)
Income (loss) before income taxes	(9,537)	10,285		748
Income tax benefit (provision)	(3,305)	(1,602)		(4,907)
Net income (loss)	(12,842)	8,683		(4,159)
Less: net income attributable to noncontrolling interest		(2,865)		(2,865)
Net income (loss) attributable to common shareholders	(12,842)	5,818		(7,024)

MERCER INTERNATIONAL INC.

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(In thousands of Euros, except per share data)

Note 13. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Statements of Cash Flows

	Three Months Ended September 30, 2013		
	Restricted Group	**Unrestricted Subsidiaries**	**Consolidated Group**
Cash flows from (used in) operating activities			
Net income (loss)	(2,299)	561	(1,738)
Adjustments to reconcile net income (loss) to cash flows from operating activities			
Unrealized loss (gain) on derivative instruments	640	(3,038)	(2,398)
Depreciation and amortization	8,192	6,502	14,694
Deferred income taxes	(115)		(115)
Stock compensation expense	621		621
Pension and other post-retirement expense, net of funding	124		124
Other	75	386	461
Changes in working capital			
Receivables	(3,350)	2,654	(696)
Inventories	(5,366)	(9,882)	(15,248)
Accounts payable and accrued expenses	2,517	6,544	9,061
Other[(1)]	(2,659)	2,736	77
Net cash from (used in) operating activities	(1,620)	6,463	4,843
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(2,199)	(4,792)	(6,991)
Acquisition of noncontrolling interest (Note 9)	(14,809)	14,809	
Proceeds on sale of property, plant and equipment	194	39	233
Net cash from (used in) investing activities	(16,814)	(10,056)	(6,758)
Cash flows from (used in) financing activities			
Repayment of debt	(544)	(21,630)	(22,174)
Proceeds from issuance of notes and borrowings of debt	39,607		39,607

Repayment of capital lease obligations	(122)	(274)	(396)
Proceeds from (repayment of) credit facilities, net	(12,226)		(12,226)
Payment of note issuance costs	(1,306)	(488)	(1,794)
Proceeds from government grants			
Net cash from (used in) financing activities	25,409	(22,392)	3,017
Effect of exchange rate changes on cash and cash equivalents	(1,367)		(1,367)
Net increase (decrease) in cash and cash equivalents	5,608	(5,873)	(265)
Cash and cash equivalents, beginning of period	69,467	64,966	134,433
Cash and cash equivalents, end of period	75,075	59,093	134,168

(1) Includes intercompany related transactions.

MERCER INTERNATIONAL INC.

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Note 13. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Statements of Cash Flows

	Three Months Ended September 30, 2012		
	Restricted Group	**Unrestricted Subsidiaries**	**Consolidated Group**
Cash flows from (used in) operating activities			
Net income (loss)	(9,957)	811	(9,146)
Adjustments to reconcile net income (loss) to cash flows from operating activities			
Unrealized loss (gain) on derivative instruments	(353)	1,236	883
Depreciation and amortization	8,385	6,669	15,054
Deferred income taxes	1,040		1,040
Stock compensation expense	891		891
Pension and other post-retirement expense, net of funding	(73)		(73)
Other	543	869	1,412
Changes in working capital			
Receivables	(6,130)	(7,992)	(14,122)
Inventories	1,693	4,141	5,834
Accounts payable and accrued expenses	9,800	(108)	9,692
Other[(1)]	(4,225)	1,986	(2,239)
Net cash from (used in) operating activities	1,614	7,612	9,226
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(6,380)	(2,772)	(9,152)
Proceeds on sale of property, plant and equipment	37	11	48
Proceeds on maturity of marketable securities	10,213		10,213
Net cash from (used in) investing activities	3,870	(2,761)	1,109
Cash flows from (used in) financing activities			
Repayment of debt	(544)	(15,000)	(15,544)
Repayment of capital lease obligations	(234)	(274)	(508)

Proceeds from government grants		778	778
Net cash from (used in) financing activities	(778)	(14,496)	(15,274)
Effect of exchange rate changes on cash and cash equivalents	221		221
Net increase (decrease) in cash and cash equivalents	4,927	(9,645)	(4,718)
Cash and cash equivalents, beginning of period	50,096	80,791	130,887
Cash and cash equivalents, end of period	55,023	71,146	126,169

(1) Includes intercompany related transactions.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 13. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Statements of Cash Flows

	Nine Months Ended September 30, 2013		
	Restricted Group	Unrestricted Subsidiaries	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss)	(15,263)	4,502	(10,761)
Adjustments to reconcile net income (loss) to cash flows from operating activities			
Unrealized loss (gain) on derivative instruments	1,144	(13,918)	(12,774)
Depreciation and amortization	24,770	19,528	44,298
Deferred income taxes	1,309	3,147	4,456
Stock compensation expense	1,194		1,194
Pension and other post-retirement expense, net of funding	457		457
Other	778	1,836	2,614
Changes in working capital			
Receivables	7,174	4,175	11,349
Inventories	3,004	(10,359)	(7,355)
Accounts payable and accrued expenses	11,143	6,945	18,088
Other[(1)]	(11,299)	4,886	(6,413)
Net cash from (used in) operating activities	24,411	20,742	45,153
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(7,446)	(21,922)	(29,368)
Acquisition of noncontrolling interest (Note 9)	(14,809)	14,809	
Proceeds on sale of property, plant and equipment	207	41	248
Net cash from (used in) investing activities	(22,048)	(7,072)	(29,120)
Cash flows from (used in) financing activities			
Repayment of debt	(1,089)	(41,630)	(42,719)
Proceeds from issuance of notes and borrowings of debt	39,607	17,000	56,607
Repayment of capital lease obligations	(366)	(1,131)	(1,497)

Proceeds from (repayment of) credit facilities, net	728		728
Payment of note issuance costs	(1,306)	(488)	(1,794)
Proceeds from government grants		4,147	4,147
Net cash from (used in) financing activities	37,574	(22,102)	15,472
Effect of exchange rate changes on cash and cash equivalents	(1,576)		(1,576)
Net increase (decrease) in cash and cash equivalents	38,361	(8,432)	29,929
Cash and cash equivalents, beginning of period	36,714	67,525	104,239
Cash and cash equivalents, end of period	75,075	59,093	134,168

(1) Includes intercompany related transactions.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 13. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Statements of Cash Flows

	Nine Months Ended September 30, 2012		
	Restricted Group	Unrestricted Subsidiaries	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss)	(12,842)	8,683	(4,159)
Adjustments to reconcile net income (loss) to cash flows from operating activities			
Unrealized loss (gain) on derivative instruments	(1,972)	636	(1,336)
Depreciation and amortization	23,958	20,034	43,992
Deferred income taxes	2,956	(5,256)	(2,300)
Stock compensation expense	1,753		1,753
Pension and other post-retirement expense, net of funding	(128)		(128)
Other	66	2,212	2,278
Changes in working capital			
Receivables	(407)	1,308	901
Inventories	3,946	5,330	9,276
Accounts payable and accrued expenses	12,180	966	13,146
Other[(1)]	(12,213)	11,312	(901)
Net cash from (used in) operating activities	17,297	45,225	62,522
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(19,413)	(8,042)	(27,455)
Proceeds on sale of property, plant and equipment	274	113	387
Proceeds on maturity of marketable securities	12,221		12,221
Net cash from (used in) investing activities	(6,918)	(7,929)	(14,847)
Cash flows from (used in) financing activities			
Repayment of debt and purchase of notes	(2,671)	(24,583)	(27,254)
Repayment of capital lease obligations	(600)	(967)	(1,567)
Payment of note issuance costs		(1,621)	(1,621)

Proceeds from government grants	2,322	778	3,100
Net cash from (used in) financing activities	(949)	(26,393)	(27,342)
Effect of exchange rate changes on cash and cash equivalents	764		764
Net increase (decrease) in cash and cash equivalents	10,194	10,903	21,097
Cash and cash equivalents, beginning of period	44,829	60,243	105,072
Cash and cash equivalents, end of period	55,023	71,146	126,169

(1) Includes intercompany related transactions.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In this document: (i) unless the context otherwise requires, references to we , our , us , the Company or Mercer me Mercer International Inc. and its subsidiaries; (ii) references to Mercer Inc. mean the Company excluding its subsidiaries; (iii) information is provided as of September 30, 2013, unless otherwise stated; (iv) all references to monetary amounts are to Euros , the lawful currency adopted by most members of the European Union, unless otherwise stated; (v) refers to Euros, $ refers to U.S. dollars and C$ refers to Canadian dollars; (vi) ADMTs refer air-dried metric tonnes; (vii) MW refers to megawatts; and (viii) MWh refers to megawatt hours.

Results of Operations

General

We operate three northern bleached softwood kraft, referred to as NBSK , pulp mills through our wholly owned subsidiaries, Rosenthal and Celgar, and our 83.0% owned subsidiary, Stendal (we increased our equity ownership from 74.9% as at September 30, 2013). We have a consolidated annual production capacity of approximately 1.5 million ADMTs.

The following discussion and analysis of our results of operations and financial condition for the three and nine months ended September 30, 2013 should be read in conjunction with our interim consolidated financial statements and related notes included in this quarterly report, as well as our most recent annual report on Form 10-K for the fiscal year ended December 31, 2012 filed with the Securities and Exchange Commission, referred to as the SEC .

On July 9, 2013, we announced that, after conducting a comprehensive assessment, our Celgar mill intends to reduce its workforce by approximately 85 employees in order to improve its competitiveness with other pulp producers by reducing the mill s fixed costs. In the current quarter, we incurred pre-tax charges of approximately 2.9 million for severance and other personnel related expenses in connection with the Celgar workforce reduction. We currently estimate incurring additional pre-tax severance and personnel charges of approximately 1.5 million to 3.0 million in connection therewith as additional personnel leave the workforce. Over 85% of these charges are expected to be recognized by the end of 2013. We expect that our Celgar mill will realize approximately 6.0 million to 7.5 million in annual pre-tax cost savings once the workforce restructuring has been fully implemented, with approximately 80% of such annual cost savings being realized in 2014.

On July 22, 2013, we issued an additional $50.0 million aggregate principal amount of 9.5% senior notes due 2017, referred to as the Senior Notes , at an issue price of 104.5% plus accrued interest from June 1, 2013. We used the proceeds to repay the revolving credit facilities of our Rosenthal and Celgar mills and for general corporate purposes.

On September 30, 2013, we completed an amendment to the Stendal mill s senior project finance credit facility and its amortizing term facility in respect of Project Blue Mill to provide the mill greater financial flexibility. As part of the amendment, we made a capital investment of $20.0 million in Stendal on such date and increased our equity ownership of Stendal to 83.0% from 74.9%.

We anticipate changing our reporting currency from Euros to the U.S. dollar commencing with the fourth quarter of 2013 as management is of the opinion that the use of U.S. dollars to prepare its financial statements will enhance communication and understanding with shareholders, analysts and other stakeholders and improve comparability of our financial information with other competitors and peer group companies. With the change in reporting currency, both the current year and historical financial information, including all comparative financial information, to be reported on our Form 10-K for the year ended December 31, 2013 will be translated to U.S. dollars.

Current Market Environment

Pulp list prices increased marginally in the third quarter of 2013. At the end of the current quarter, list prices in Europe were approximately $880 per ADMT and in North America and China were approximately $945 and $695 per ADMT, respectively.

We currently expect demand and pricing to trend upwards in the fourth quarter of 2013. We expect increased demand to be driven by new tissue capacity coming online in China, and we expect supply to remain tight in the medium term due to the closure of a Norwegian mill (Tofte) and producer maintenance downtime.

Summary Financial Highlights

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands, other than per share amounts)			
Pulp revenues	186,100	205,122	559,879	590,597
Energy and chemical revenues	17,021	18,153	51,660	55,098
Operating income (loss)	10,072	7,214	18,779	41,753
Gain (loss) on derivative instruments	1,978	(883)	12,091	1,336
Income tax provision	(942)	(1,910)	(2,434)	(4,907)
Net loss[1]	(2,220)	(9,712)	(12,556)	(7,024)
Net loss per share[1][2]	(0.04)	(0.17)	(0.23)	(0.13)

(1) Attributable to common shareholders.
(2) Per share amounts are on a basic and diluted basis.

Selected Production, Sales and Other Data

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Consolidated				
Pulp production (000 ADMTs)	369.0	373.4	1,079.7	1,118.8
Scheduled production downtime (000 ADMTs)	9.4	10.2	25.4	32.8
Scheduled production downtime (days)	10	7	21	30
Pulp sales (000 ADMTs)	356.6	404.3	1,081.6	1,138.3
Average NBSK pulp list prices in Europe ($/ADMT)[1]	867	777	852	817
Average NBSK pulp list prices in Europe (/ADMT)	654	620	646	637
Average pulp sales realizations (/ADMT)[2]	515	501	511	512
Energy production (000 MWh)	444.2	436.5	1,274.4	1,298.2
Energy sales (000 MWh)	185.4	181.3	526.6	546.4
Average energy sales realizations (/MWh)	80	84	84	85
Average Spot Currency Exchange Rates				
/ $[3]	0.7547	0.7999	0.7594	0.7807
C$ / $[3]	1.0385	0.9954	1.0236	1.0022
C$ / [4]	1.3762	1.2452	1.3485	1.2847

(1) Source: RISI pricing report.
(2) Sales realizations after discounts. Incorporates the effect of pulp price variations occurring between the order and shipment dates.
(3) Average Federal Reserve Bank of New York noon spot rate over the reporting period.
(4) Average Bank of Canada noon spot rate over the reporting period.

Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012

Total revenues for the three months ended September 30, 2013 decreased by approximately 9% to 203.1 million from 223.3 million in the same period in 2012, due to lower pulp revenues and marginally lower energy and chemical revenues.

Pulp revenues for the three months ended September 30, 2013 decreased to 186.1 million from 205.1 million in the comparative quarter of 2012, primarily due to lower sales volumes and the impact of a weaker U.S. dollar relative to the Euro, partially offset by a higher realized price.

Energy and chemical revenues decreased by approximately 7% to 17.0 million in the third quarter of 2013 from 18.2 million in the same quarter last year, primarily as a result of lower prices.

Average list prices for NBSK pulp in Europe were approximately $867 (654) per ADMT in the current quarter, compared to approximately $777 (620) per ADMT in the same quarter last year. In the third quarter of 2013, average pulp sales realizations increased by approximately 3% to 515 per ADMT from approximately 501 per ADMT in the same quarter last year, primarily due to higher pulp prices partially offset by a weaker U.S. dollar relative to the Euro.

Pulp production decreased by approximately 1% to 369,011 ADMTs in the current quarter from 373,369 ADMTs in the same quarter of 2012. We took 10 days (approximately 9,400 ADMTs) of scheduled maintenance downtime at our

Rosenthal mill in the third quarter of 2013, compared to seven days (approximately 10,200 ADMTs) of scheduled maintenance downtime at our Celgar mill in the third quarter of 2012.

Pulp sales volumes decreased by approximately 12% to 356,619 ADMTs in the current quarter from 404,301 ADMTs in the comparative quarter, primarily due to lower sales to China, compared to exceedingly high sales to China in the comparative quarter.

Costs and expenses in the third quarter of 2013 decreased by approximately 11% to 193.0 million from 216.1 million in the comparative period of 2012, primarily due to lower sales volumes and the reversal of certain wastewater fee accruals at our Rosenthal mill.

In the third quarter of 2013, operating depreciation and amortization marginally decreased to 14.6 million from 15.0 million in the same quarter last year. Selling, general and administrative expenses were 9.4 million in the third quarter of 2013, compared to 10.0 million in the third quarter of 2012.

In the third quarter of 2013, we incurred pre-tax charges of approximately 2.9 million for severance and other personnel related expenses in connection with the Celgar mill workforce reduction.

Transportation costs decreased to 17.1 million in the third quarter of 2013 from 21.1 million in the third quarter of 2012, primarily due to lower sales volumes.

On average, our overall per unit fiber costs in the current quarter increased by approximately 7% from the same period in 2012 as higher fiber costs in Germany were only partially offset by lower fiber costs in Canada. Strong demand from the European pellet and board producers kept fiber prices at relatively high levels in the current quarter. Fiber costs at our Celgar mill decreased as a result of strong sawmill activity in the region. For the remainder of the year, we currently expect fiber costs in Germany to increase slightly and to remain largely unchanged in Canada.

For the third quarter of 2013, our operating income increased to 10.1 million from 7.2 million in the comparative quarter of 2012, primarily due to higher pulp sales realizations.

Interest expense in the third quarter of 2013 decreased to 13.0 million from 14.1 million in the comparative quarter of 2012, primarily due to lower debt levels associated with the Stendal mill in the third quarter of 2013.

We recorded a net derivative gain of 2.0 million, which includes an unrealized gain of approximately 3.0 million on the mark to market adjustment of our Stendal mill s interest rate derivative, partially offset by an approximately 1.0 million loss related to fixed price pulp swap contracts entered into in the fourth quarter of 2012, compared to a net derivative loss of 0.9 million in the same quarter of last year.

During the current quarter, we recorded a net income tax expense of 0.9 million, compared to 1.9 million in the same quarter of 2012.

The noncontrolling shareholder s interest in the Stendal mill s net income in the third quarter of 2013 was 0.5 million, compared to 0.6 million in the same quarter last year.

We reported a net loss attributable to common shareholders of 2.2 million, or 0.04 per basic and diluted share, for the third quarter of 2013, which included a net non-cash unrealized gain of 2.4 million on the fixed price pulp swaps and Stendal interest rate derivative. In the third quarter of 2012, the net loss attributable to common shareholders was 9.7 million, or 0.17 per basic and diluted share, which included a total non-cash unrealized loss of 1.3 million on the Stendal interest rate derivative and fixed price pulp swaps.

In the third quarter of 2013, Operating EBITDA increased to 24.8 million from 22.3 million in the third quarter of 2012. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges.

Operating EBITDA does not reflect the impact of a number of items that affect our net income (loss) attributable to common shareholders, including financing costs and the effect of derivative instruments. Operating EBITDA is not a measure of financial performance under the accounting principles generally accepted in the United States of America, referred to as GAAP , and should not be considered as an alternative to net income (loss) or income (loss) from operations as a measure of performance, nor as an alternative to net cash from operating activities as a measure of liquidity.

Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are that Operating EBITDA does not reflect: (i) our cash expenditures, or future requirements, for capital expenditures or contractual commitments; (ii) changes in, or cash requirements for, working capital needs; (iii) the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our outstanding debt; (iv) noncontrolling interests on our Stendal mill operations; (v) the impact of realized or marked to market changes in our derivative positions, which can be substantial; and (vi) the impact of impairment charges against our investments or assets. Because of these limitations, Operating EBITDA should only be considered as a supplemental operational performance measure and should not be considered as a measure of liquidity or cash available to us to invest in the growth of our business. See the Statement of Cash Flows set out in our interim consolidated financial statements included herein. Because all companies do not calculate Operating EBITDA in the same manner, Operating EBITDA as calculated by us may differ from Operating EBITDA or EBITDA as calculated by other companies. We compensate for these limitations by using Operating EBITDA as a supplemental measure of our operational performance and relying primarily on our GAAP financial statements.

The following table provides a reconciliation of net loss attributable to common shareholders to operating income and Operating EBITDA for the periods indicated:

	Three Months Ended September 30,	
	2013	**2012**
	(in thousands)	
Net loss attributable to common shareholders	(2,220)	(9,712)
Net income attributable to noncontrolling interest	482	566
Income tax provision	942	1,910
Interest expense	13,018	14,084
(Gain) loss on derivative instruments	(1,978)	883
Other income	(172)	(517)
Operating income	10,072	7,214
Add: Depreciation and amortization	14,694	15,054
Operating EBITDA	24,766	22,268

Nine Months Ended September 30, 2013 Compared to Nine Months Ended September 30, 2012

Total revenues for the nine months ended September 30, 2013 decreased by approximately 5% to 611.5 million from 645.7 million in the same period in 2012, due to both lower pulp and energy and chemical revenues.

Pulp revenues for the nine months ended September 30, 2013 decreased to 559.9 million from 590.6 million in the comparative period of 2012, primarily due to lower pulp sales volumes and a weaker U.S. dollar relative to the Euro. The U.S. dollar was approximately 3% weaker versus the Euro in the nine months ended September 30, 2013, compared to the same period of last year.

Energy and chemical revenues decreased by approximately 6% to 51.7 million in the nine months ended September 30, 2013 from 55.1 million in the same period last year, primarily as a result of lower pulp production and lower prices.

Average list prices for NBSK pulp in Europe were approximately $852 (646) per ADMT in the nine months ended September 30, 2013, compared to approximately $817 (637) per ADMT in the same period last year. In the nine months ended September 30, 2013, average pulp sales realizations decreased moderately to 511 per ADMT from approximately 512 per ADMT in the same period last year, as the increase in pulp prices was more than offset by the impact of a weaker U.S. dollar versus the Euro.

Pulp production decreased by approximately 3% to 1,079,677 ADMTs in the nine months ended September 30, 2013 from 1,118,758 ADMTs in the same period of 2012, primarily due to lower pulp production at our Celgar mill. In the second quarter of 2013, the Celgar mill took its annual maintenance shutdown. As a result of weather, equipment and execution issues, the shutdown was four days longer and the startup was slower than budgeted, which resulted in a loss of approximately 30,300 ADMTs of NBSK pulp production.

Pulp sales volumes decreased by approximately 5% to 1,081,564 ADMTs in the nine months ended September 30, 2013 from 1,138,304 ADMTs in the comparative period of 2012, primarily due to lower sales to China and the United States.

Costs and expenses in the nine months ended September 30, 2013 decreased by approximately 2% to 592.8 million from 603.9 million in the comparative period of 2012, primarily due to lower sales volumes and the reversal of certain wastewater fee accruals at our Rosenthal mill.

In the nine months ended September 30, 2013, operating depreciation and amortization increased to 44.1 million from 43.8 million in the same period last year. Selling, general and administrative expenses were 27.7 million in the nine months ended September 30, 2013, compared to 28.7 million in the same period of 2012.

In the nine months ended September 30, 2013, we incurred pre-tax charges of approximately 2.9 million for severance and other personnel related expenses in connection with the Celgar mill workforce reduction.

Transportation costs decreased to 51.5 million in the nine months ended September 30, 2013 from 56.5 million in the same period of 2012, primarily due to lower pulp sales volumes.

On average, our per unit fiber costs in the nine months ended September 30, 2013 increased by approximately 4% from the same period in 2012. During the nine months ended September 30, 2013, fiber costs at our German mills were higher than the comparative period in 2012. Strong demand from the European pellet and board producers and sawmills, reduced wood supply because of extreme winter weather conditions and lower availability of trucking transportation kept fiber prices at relatively high levels in the current period. Fiber costs at our Celgar mill decreased as a result of strong sawmill activity in the region. For the remainder of the year, we currently expect fiber costs in Germany to increase slightly and to remain largely unchanged in Canada.

For the nine months ended September 30, 2013, operating income decreased to 18.8 million from 41.8 million in the comparative period of 2012, primarily due to the combined effect of higher fiber costs, the impact of a weaker U.S. dollar relative to the Euro and the Celgar mill s maintenance shutdown.

Interest expense in the nine months ended September 30, 2013 decreased to 39.3 million from 42.1 million in the comparative period of 2012, primarily due to lower debt levels associated with the Stendal mill.

We recorded a net derivative gain of 12.1 million, which includes an unrealized gain of approximately 13.9 million on the mark to market adjustment of our Stendal mill s interest rate derivative, partially offset by an approximately 1.8 million loss related to fixed price pulp swap contracts entered into in the fourth quarter of 2012, compared to a net derivative gain of 1.3 million in the same period of last year.

During the nine months ended September 30, 2013, we recorded a net income tax expense of 2.4 million, compared to 4.9 million in the same period of 2012.

The noncontrolling shareholder s interest in the Stendal mill s income in the nine months ended September 30, 2013 was 1.8 million, compared to 2.9 million in the same period last year.

We reported a net loss attributable to common shareholders of 12.6 million, or 0.23 per basic and diluted share, for the nine months ended September 30, 2013, which included a net non-cash unrealized gain of 12.8 million on the fixed price pulp swaps and Stendal interest rate derivative, partially offset by a negative impact of approximately 11.0 million related to the Celgar maintenance shutdown. In the nine months ended September 30, 2012, the net loss attributable to common shareholders was 7.0 million, or 0.13 per basic and diluted share, which included a net non-cash unrealized gain of 0.8 million on the fixed price pulp swaps and Stendal interest rate derivative.

Operating EBITDA in the nine months ended September 30, 2013 was 63.1 million, compared to 85.7 million in the nine months ended September 30, 2012. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our results for the three months ended September 30, 2013 for additional information relating to such limitations of Operating EBITDA.

The following table provides a reconciliation of net loss attributable to common shareholders to operating income and Operating EBITDA for the periods indicated:

	Nine Months Ended September 30,	
	2013	**2012**
	(in thousands)	
Net loss attributable to common shareholders	(12,556)	(7,024)
Net income attributable to noncontrolling interest	1,795	2,865
Income tax provision	2,434	4,907
Interest expense	39,305	42,080
Gain on derivative instruments	(12,091)	(1,336)
Other (income) expense	(108)	261
Operating income	18,779	41,753
Add: Depreciation and amortization	44,298	43,992
Operating EBITDA	63,077	85,745

Liquidity and Capital Resources

The following table is a summary of selected financial information as at the dates indicated:

	As at September 30, 2013	As at December 31, 2012
	(in thousands)	
Financial Position		
Cash and cash equivalents	134,168	104,239
Working capital	222,981	208,573
Total assets	1,176,484	1,183,603
Long-term liabilities	766,087	768,253
Total equity	262,673	278,925

As at September 30, 2013, we had approximately 28.3 million and C$21.4 million available under our Rosenthal and Celgar revolving facilities, respectively.

As at September 30, 2013, our cash and cash equivalents had increased to 134.2 million from 104.2 million and working capital had increased to 223.0 million from 208.6 million at the end of 2012.

On July 22, 2013, we completed our registered public offering of an additional $50.0 million aggregate principal amount of Senior Notes at an issue price of 104.5% plus accrued interest from June 1, 2013. We used the proceeds to repay the revolving credit facilities of our Rosenthal and Celgar mills and for general corporate purposes.

On September 30, 2013, we completed an amendment to the Stendal Facilities (as defined below) to provide the mill greater financial flexibility. As part of the amendment, we made a capital investment of $20.0 million in Stendal on such date and increased our equity ownership of Stendal to 83.0% from 74.9%.

Sources and Uses of Funds

Our principal sources of funds are cash flows from operations, cash and cash equivalents on hand and the revolving working capital loan facilities for our Celgar and Rosenthal mills. Our principal uses of funds consist of operating expenditures, payments of principal and interest on the project loan facilities relating to our development of the Stendal mill (the Stendal Loan Facility) and for its Project Blue Mill (collectively, the Stendal Facilities), capital expenditures and interest payments on our outstanding Senior Notes.

Debt Covenants

Our long-term obligations contain various financial tests and covenants customary to these types of arrangements.

The Stendal Facilities had approximately 428.3 million in total principal outstanding at September 30, 2013. The Stendal Facilities are without recourse to the Restricted Group (comprised of Mercer, the Rosenthal and Celgar mills and certain holding subsidiaries) and 80% of the principal amount thereunder is severally guaranteed by German federal and state governments.

On September 30, 2013, the Stendal mill completed an amendment agreement (the Amendment) with its lending syndicate (the Lenders) to amend the Stendal Facilities. The Amendment modifies the Stendal Facilities to provide the Stendal mill greater financial flexibility by, among other things: (i) waiving compliance with an annual debt service cover ratio and a stipulated semi-annual leverage ratio (the Ratios) until and including December 31, 2013; (ii) amending the Ratios so that the financial covenants now deduct from senior debt cash in the debt service reserve account and cash above a stipulated threshold in order to include certain cash reserves in the calculation of senior debt; (iii) providing that a failure to satisfy the covenant to maintain an annual debt service cover ratio under the Stendal Facilities would only be an event of default when amounts in the debt service reserve account plus certain cash reserves are below a specified threshold; and (iv) revising the calculation of amounts required to cure financial covenant defaults under the Stendal Facilities.

Cash Flow Analysis

Cash Flows from Operating Activities. We operate in a cyclical industry and our operating cash flows vary accordingly. Our principal operating cash expenditures are for labor, fiber and chemicals.

Working capital levels fluctuate throughout the year and are affected by maintenance downtime, changing sales patterns, seasonality and the timing of receivables and the payment of payables and expenses.

Cash provided by operating activities decreased to 45.2 million in the nine months ended September 30, 2013 from 62.5 million in the comparative period of 2012, primarily due to weaker operating performance. An increase in accounts payable and accrued expenses provided cash of 18.1 million, compared to 13.1 million in the same period of 2012. An increase in inventories used cash of 7.4 million in the nine months ended September 30, 2013, compared to a decrease in inventories providing cash of 9.3 million in the same period of 2012. A decrease in receivables provided cash of 11.3 million in the nine months ended September 30, 2013, compared to providing cash of 0.9 million in the same period of 2012.

Cash Flows from Investing Activities. Investing activities in the nine months ended September 30, 2013 used cash of 29.1 million, compared to 14.8 million in the same period of 2012. Capital expenditures in the nine months ended September 30, 2013 used cash of 29.4 million, compared to 27.5 million in the same period of 2012. Capital expenditures related to Project Blue Mill used cash of 21.7 million in the nine months ended September 30, 2013.

Cash Flows from Financing Activities. In the nine months ended September 30, 2013, financing activities provided cash of 15.5 million, compared to using cash of 27.3 million in the same period of 2012. In the nine months ended September 30, 2013, principal repayments under the Stendal Loan Facility used cash of 40.0 million, compared to 24.6 million in the same period of 2012. During the nine months ended September 30, 2013, borrowing under the loan facility for Project Blue Mill provided cash of 17.0 million and the issuance of an additional $50.0 million of Senior Notes provided cash of 39.6 million. Net borrowing from our revolving credit facilities provided cash of 0.7 million in the nine months ended September 30, 2013, compared to nil in the same period of 2012. In the nine months ended September 30, 2013 and 2012, proceeds of government grants provided cash of 4.1 million and 3.1 million, respectively.

Capital Commitments and Future Liquidity

Project Blue Mill, designed to increase our Stendal mill s annual energy production by 109,000 MWh and annual pulp production by 30,000 ADMTs, is expected to be finalized in mid-November 2013. The project was on schedule and budget and started to generate power sales at the end of September 2013. Project Blue Mill has also received an investment decree, determining that it qualifies for up to 12.0 million in governmental grants, comprised of 9.2 million of investment incentives and 2.8 million of tax grants. The actual receipt of such grants is subject to the Stendal mill satisfying all governmental rules including verification. As at September 30, 2013, the Stendal mill, based on expenditures to date, had applied for 6.9 million and received 4.1 million in grants.

Based upon the current level of operations and our current expectations for future periods in light of the current economic environment, and in particular, current and expected pulp pricing and foreign exchange rates, we believe that cash flow from operations and available cash, together with available borrowings will be adequate to meet our liquidity needs in the next 12 months.

We currently have no material commitments to acquire assets or operating businesses. We anticipate that there may be acquisitions or commitments to capital projects in the future. To achieve the long-term goals of expanding our assets and earnings, additional capital resources may be required. Depending on the size of a transaction or project, the capital resources that will be required can be substantial. The necessary resources will be generated from cash flow from operations, cash on hand, borrowing against our assets or the issuance of securities.

Contractual Obligations and Commitments

There were no material changes outside the ordinary course to any of our material contractual obligations during the nine months ended September 30, 2013.

In July 2013, we renewed the collective agreement for our Rosenthal mill for an additional two year period until June 2015. The agreement provides for, among other things, an initial 1.8% wage increase for employees thereunder, with a subsequent 3% wage increase in May 2014.

Foreign Currency

Our reporting currency is currently the Euro as the majority of our business transactions are denominated in Euros. However, we hold certain assets and liabilities in U.S. dollars and Canadian dollars. Further, the majority of our sales are in products quoted in U.S. dollars, whereas most of our operating costs and expenses are incurred in Euros and, to a lesser extent, Canadian dollars. Accordingly, our consolidated financial results are subject to foreign currency exchange rate fluctuations.

We translate foreign denominated assets and liabilities into Euros at the rate of exchange on the balance sheet date. Equity accounts are translated using historical exchange rates. Unrealized gains or losses from these translations are recorded in our Consolidated Statement of Comprehensive Income (Loss) and impact shareholders equity on the Consolidated Balance Sheet but do not affect our net income (loss).

In the nine months ended September 30, 2013, accumulated other comprehensive income decreased by 6.6 million to 18.6 million, primarily due to the foreign currency translation adjustment.

Based upon the exchange rate at September 30, 2013, the U.S. dollar has weakened by approximately 5% in value against the Euro since September 30, 2012. See Quantitative and Qualitative Disclosures about Market Risk .

We anticipate changing our reporting currency from Euros to the U.S. dollar commencing with the fourth quarter of 2013 as management is of the opinion that the use of U.S. dollars to prepare its financial statements will enhance communication and understanding with shareholders, analysts and other stakeholders and improve comparability of our financial information with other competitors and peer group companies. With the change in reporting currency, both the current year and historical financial information, including all comparative financial information, to be reported on our Form 10-K for the year ended December 31, 2013 will be translated to U.S. dollars.

Results of Operations of the Restricted Group under our Senior Note Indenture

General

The indenture governing our Senior Notes requires that we also provide a discussion in annual and quarterly reports we file with the SEC under Management s Discussion and Analysis of Financial Condition and Results of Operations of the results of operations and financial condition of Mercer Inc. and our restricted subsidiaries under the indenture, referred to as the Restricted Group . The Restricted Group is comprised of Mercer Inc., our Rosenthal and Celgar mills and certain holding subsidiaries. The Restricted Group excludes our Stendal mill.

The following is a discussion of the results of operations and financial condition of the Restricted Group. For further information regarding the Restricted Group including, without limitation, a reconciliation to our consolidated results of operations, see Note 13 of our Interim Consolidated Financial Statements included herein.

Summary Financial Highlights for the Restricted Group

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands)		(in thousands)	
Pulp revenues	105,794	112,777	311,575	326,411
Energy and chemical revenues	5,935	6,960	19,065	21,411
Operating income (loss)	4,250	(4,773)	2,271	2,840
Gain (loss) on derivative instruments	(1,060)	353	(1,827)	1,972
Income tax provision	(1,087)	(1,192)	(2,714)	(3,305)
Net loss	(2,299)	(9,957)	(15,263)	(12,842)

Selected Production, Sales and Other Data for the Restricted Group

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Restricted Group				
Pulp production (000 ADMTs)	198.8	204.1	596.4	616.8
Scheduled production downtime (000 ADMTs)	9.4	10.2	25.4	32.8
Scheduled production downtime (days)	10	7	21	30
Pulp sales (000 ADMTs)	205.9	224.7	607.7	634.7
Average NBSK pulp list prices in Europe ($/ADMT)[1]	867	777	852	817
Average NBSK pulp list prices in Europe (/ADMT)	654	620	646	637
Average pulp sales realizations (/ADMT)[2]	514	502	513	514
Energy production (000 MWh)	225.8	233.1	672.4	695.5
Energy sales (000 MWh)	82.3	86.0	241.1	260.1
Average energy sales realizations (/MWh)	72	81	79	82
Average Spot Currency Exchange Rates				
/ $[3]	0.7547	0.7999	0.7594	0.7807
C$ / $[3]	1.0385	0.9954	1.0236	1.0022
C$ / [4]	1.3762	1.2452	1.3485	1.2847

(1) Source: RISI pricing report.
(2) Sales realizations after discounts. Incorporates the effect of pulp price variations occurring between the order and shipment dates.
(3) Average Federal Reserve Bank of New York noon spot rate over the reporting period.
(4) Average Bank of Canada noon spot rate over the reporting period.

Restricted Group Results Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012

Total revenues for the Restricted Group decreased by approximately 7% to 111.7 million in the third quarter of 2013, compared to 119.7 million in the third quarter of 2012, primarily due to lower pulp revenues.

Pulp revenues for the Restricted Group for the three months ended September 30, 2013 decreased to 105.8 million from 112.8 million in the comparative period of 2012, primarily due to lower pulp sales volumes and a weaker U.S. dollar relative to the Euro, partially offset by a higher realized price. The U.S. dollar was approximately 6% weaker versus the Euro in the third quarter of 2013, compared to the third quarter of 2012.

Energy revenues decreased by approximately 16% in the current quarter to 5.9 million from 7.0 million in the same period last year, primarily as a result of lower pulp production at our Rosenthal mill and lower prices.

Average list prices for NBSK pulp in Europe were approximately $867 (654) per ADMT in the current quarter, compared to $777 (620) per ADMT in the same quarter last year. In the third quarter of 2013, average pulp sales realizations for the Restricted Group increased by approximately 2% to 514 per ADMT from 502 per ADMT in the same period last year, primarily due to higher pulp prices, partially offset by a weaker U.S. dollar relative to the Euro.

Pulp production for the Restricted Group decreased by approximately 3% to 198,755 ADMTs in the third quarter of 2013 from 204,124 ADMTs in the same period of 2012. We took 10 days (approximately 9,400 ADMTs) of scheduled maintenance downtime at our Rosenthal mill in the third quarter of 2013, compared to seven days (approximately 10,200 ADMTs) of scheduled maintenance downtime at our Celgar mill in the third quarter of 2012.

Pulp sales volumes of the Restricted Group decreased by approximately 8% to 205,924 ADMTs in the third quarter of 2013 from 224,696 ADMTs in the comparative period of 2012, primarily due to lower sales to China, compared to high sales to China in the comparative quarter.

Costs and expenses for the Restricted Group in the third quarter of 2013 decreased by approximately 14% to 107.5 million from 124.5 million in the comparative period of 2012, primarily due to lower sales volumes and the reversal of certain wastewater fee accruals at our Rosenthal mill.

In the third quarter of 2013, operating depreciation and amortization for the Restricted Group was 8.1 million, compared to 8.3 million in the same quarter last year. Selling, general and administrative expenses for the Restricted Group were 5.6 million, compared to 6.4 million in the same period of 2012.

In the third quarter of 2013, the Restricted Group incurred pre-tax charges of approximately 2.9 million for severance and other personnel related expenses in connection with the Celgar mill workforce reduction.

Transportation costs for the Restricted Group decreased to 12.5 million in the third quarter of 2013 from 14.6 million in the same quarter last year.

Overall, per unit fiber costs of the Restricted Group in the third quarter of 2013 were flat, compared to the same period in 2012. During the third quarter of 2013, fiber costs at our Rosenthal mill were higher than the comparative period in 2012. Strong demand from the European pellet and board producers kept fiber prices at relatively high levels in the current quarter. Fiber costs at our Celgar mill decreased as a result of strong sawmill activity in the region. For the remainder of the year, we currently expect fiber costs at our Rosenthal mill to increase slightly, whereas we expect fiber costs at our Celgar mill to remain largely unchanged.

In the third quarter of 2013, the Restricted Group reported operating income of 4.3 million, compared to an operating loss of 4.8 million in the third quarter of 2012, primarily due to a higher pulp sales realization.

Interest expense for the Restricted Group increased moderately to 6.2 million in the third quarter of 2013 from 6.0 million in the same quarter of last year.

In the third quarter of 2013, the Restricted Group also recorded a loss on derivative instruments of approximately 1.1 million related to two fixed price pulp swap contracts entered into in the fourth quarter of 2012, compared to a derivative gain of approximately 0.3 million in the same quarter of 2012.

During the third quarter of 2013, the Restricted Group recorded 1.1 million of net income tax expense, compared to income tax expense of 1.2 million in the same period last year.

The net loss reported by the Restricted Group for the third quarter of 2013 declined to 2.3 million from 10.0 million in the same period last year, primarily due to higher pulp sales realizations and the reversal of certain wastewater fee accruals at our Rosenthal mill, partially offset by Celgar restructuring costs.

In the third quarter of 2013, the Restricted Group s Operating EBITDA increased to 12.4 million from 3.6 million in the same quarter of 2012. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our consolidated results for the three months ended September 30, 2013 for additional information relating to such limitations of Operating EBITDA.

The following table provides a reconciliation of net loss to operating income (loss) and Operating EBITDA for the Restricted Group for the periods indicated:

	Three Months Ended September 30,	
	2013	**2012**
	(in thousands)	
Restricted Group[(1)]		
Net loss	(2,299)	(9,957)
Income tax provision (benefit)	1,087	1,192
Interest expense	6,193	6,010
Loss (gain) on derivative instruments	1,060	(353)
Other (income) expense	(1,791)	(1,665)
Operating income (loss)	4,250	(4,773)
Add: Depreciation and amortization	8,192	8,385
Operating EBITDA	12,442	3,612

(1) See Note 13 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results.

Restricted Group Results Nine Months Ended September 30, 2013 Compared to Nine Months Ended September 30, 2012

Total revenues for the Restricted Group decreased by approximately 5% to 330.6 million in the nine months ended September 30, 2013, compared to 347.8 million in the nine months ended September 30, 2012, primarily due to lower pulp and energy revenues at our Celgar mill.

Pulp revenues for the Restricted Group for the nine months ended September 30, 2013 decreased to 311.6 million from 326.4 million in the comparative period of 2012, primarily due to lower pulp sales volumes and a weaker U.S. dollar relative to the Euro. The U.S. dollar was approximately 3% weaker versus the Euro in the nine months ended September 30, 2013, compared to the same period of 2012.

Energy revenues decreased by approximately 11% in the nine months ended September 30, 2013 to 19.1 million from 21.4 million in the same period last year, primarily as a result of lower pulp production at our Celgar mill and lower prices.

Average list prices for NBSK pulp in Europe were approximately $852 (646) per ADMT in the nine months ended September 30, 2013, compared to $817 (637) per ADMT in the same period last year. In the nine months ended September 30, 2013, average pulp sales realizations for the Restricted Group decreased marginally to 513 per ADMT from 514 per ADMT in the same period last year due to the impact of a weaker U.S. dollar compared to the Euro, mostly offset by higher NBSK list prices.

Pulp production for the Restricted Group decreased by approximately 3% to 596,447 ADMTs in the nine months ended September 30, 2013 from 616,837 ADMTs in the same period of 2012, primarily due to lower pulp production at our Celgar mill. In the second quarter of 2013, the Celgar mill took its annual maintenance shutdown. As a result of weather, equipment and execution issues, the shutdown was four days longer and the startup slower than budgeted, which resulted in a loss of approximately 30,300 ADMTs of NBSK pulp production.

Pulp sales volumes of the Restricted Group decreased by approximately 4% to 607,695 ADMTs in the nine months ended September 30, 2013 from 634,687 ADMTs in the comparative period of 2012, primarily due to lower sales to China and the United States.

Costs and expenses for the Restricted Group in the nine months ended September 30, 2013 decreased to 328.4 million from 345.0 million in the comparative period of 2012, primarily due to lower sales volumes and the reversal of certain wastewater fee accruals at our Rosenthal mill.

In the nine months ended September 30, 2013, operating depreciation and amortization for the Restricted Group was 24.6 million, compared to 23.8 million in the same period last year. Selling, general and administrative expenses for the Restricted Group were 17.0 million, compared to 18.3 million in the same period of 2012.

In the nine months ended September 30, 2013, the Restricted Group incurred pre-tax charges of approximately 2.9 million for severance and other personnel related expenses in connection with the Celgar mill workforce reduction.

Transportation costs for the Restricted Group decreased to 36.4 million in the nine months ended September 30, 2013 from 40.3 million in the same period last year primarily due to lower pulp sales volumes.

Overall, per unit fiber costs of the Restricted Group in the nine months ended September 30, 2013 were flat, compared to the same period in 2012. During the nine months ended September 30, 2013, fiber costs at our Rosenthal mill were higher than the comparative period in 2012. Strong demand from the European pellet and board producers and sawmills, reduced wood supply because of extreme winter weather conditions and lower availability of trucking transportation kept fiber prices at relatively high levels in the current period. Fiber costs at our Celgar mill decreased as a result of strong sawmill activity in the region. For the remainder of the year, we currently expect fiber costs at our Rosenthal mill to increase slightly, whereas we expect fiber costs at our Celgar mill to remain largely unchanged.

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In the nine months ended September 30, 2013, the Restricted Group reported operating income of 2.3 million, compared to operating income of 2.8 million in the nine months ended September 30, 2012, primarily due to the combined effect of the impact of a weaker U.S. dollar relative to the Euro and the Celgar mill s maintenance shutdown, partially offset by higher NBSK list prices.

Interest expense for the Restricted Group increased marginally to 17.9 million in the nine months ended September 30, 2013 from 17.8 million in the same period last year.

In the nine months ended September 30, 2013, the Restricted Group also recorded a loss on derivative instruments of approximately 1.8 million related to two fixed price pulp swap contracts entered into in the fourth quarter of 2012, compared to a derivative gain of approximately 1.9 million in the same period of last year.

During the nine months ended September 30, 2013, the Restricted Group recorded 2.7 million of income tax expense, compared to 3.3 million in the same period last year.

The net loss reported by the Restricted Group increased to 15.3 million from 12.8 million in the same period last year.

In the nine months ended September 30, 2013, the Restricted Group s Operating EBITDA increased to 27.0 million from 26.8 million in the comparative period of 2012. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our consolidated results for the three months ended September 30, 2013 for additional information relating to such limitations of Operating EBITDA.

The following table provides a reconciliation of net loss to operating income and Operating EBITDA for the Restricted Group for the periods indicated:

	Nine Months Ended September 30,	
	2013	**2012**
	(in thousands)	
Restricted Group[1]		
Net loss	(15,263)	(12,842)
Income tax provision (benefit)	2,714	3,305
Interest expense	17,939	17,754
Loss (gain) on derivative instruments	1,827	(1,972)
Other expense (income)	(4,946)	(3,405)
Operating income	2,271	2,840
Add: Depreciation and amortization	24,770	23,958
Operating EBITDA	27,041	26,798

(1) See Note 13 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results.

Liquidity and Capital Resources of the Restricted Group

The following table is a summary of selected financial information for the Restricted Group as at the dates indicated:

	As at September 30, 2013	As at December 31, 2012
	(in thousands)	
Restricted Group Financial Position[1]		
Cash and cash equivalents	75,075	36,714
Working capital	153,421	132,130
Total assets	651,112	644,119
Long-term liabilities	298,214	260,185
Total equity	299,722	335,353

(1) See Note 13 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results.

At September 30, 2013, cash and cash equivalents for the Restricted Group increased to 75.1 million from 36.7 million at the end of 2012. As at September 30, 2013, we had approximately 28.3 million and C$21.4 million available under our Rosenthal and Celgar revolving credit facilities, respectively.

On July 22, 2013, we completed our registered public offering of an additional $50.0 million aggregate principal amount of additional Senior Notes at an issue price of 104.5% plus accrued interest from June 1, 2013. We used the proceeds to repay the revolving credit facilities of our Rosenthal and Celgar mills and for general corporate purposes.

We currently expect the Restricted Group to meet its interest and debt service obligations and meet the working and maintenance capital requirements for its operations for the next 12 months with cash flow from operations, cash on hand and available borrowings.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect both the amount and the timing of the recording of assets, liabilities, revenues, and expenses in the consolidated financial statements and accompanying note disclosures. Our management routinely makes judgments and estimates about the effects of matters that are inherently uncertain. As the number of variables and assumptions affecting the probable future resolution of the uncertainties increase, these judgments become even more subjective and complex.

Our significant accounting policies are disclosed in Note 1 to our annual report on Form 10-K for the fiscal year ended December 31, 2012. While all of the significant accounting policies are important to the consolidated financial statements, some of these policies may be viewed as having a high degree of judgment. On an ongoing basis, using currently available information, management reviews its estimates, including those related to the accounting for, among other things doubtful accounts and reserves, depreciation and amortization, future cash flows associated with impairment testing for long-lived assets, derivative financial instruments, environmental conservation and legal liabilities, asset retirement obligations, pensions and post-retirement benefit obligations, income taxes, contingencies, and inventory obsolescence and provisions. Actual results could differ materially from these estimates, and changes in these estimates are recorded when known.

We have identified certain accounting policies that are the most important to the portrayal of our current financial condition and results of operations.

For information about both our significant and critical accounting policies, see our annual report on Form 10-K for the fiscal year ended December 31, 2012.

Cautionary Statement Regarding Forward-Looking Information

The statements in this report that are not reported financial results or other historical information are forward-looking statements within the meaning of the *Private Securities Litigation Reform Act of 1995*, as amended.

Generally, forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words such as expects , anticipates , intends , plans , believes , seeks , estimate words of similar meaning, or future or conditional verbs, such as will , should , could , or may , although not all forward-looking statements contain these identifying words. Forward-looking statements are based on expectations, forecasts and assumptions by our management and involve a number of risks, uncertainties and other factors, many of which are beyond our control, that could cause actual conditions, events or results to differ significantly from those described in the forward-looking statements. These factors include, but are not limited to, the following:

- the highly cyclical nature of our business;
- our level of indebtedness could negatively impact our financial condition and results of operations;
- a weakening of the global economy could adversely affect our business and financial results and have a material adverse effect on our liquidity and capital resources;
- cyclical fluctuations in the price and supply of our raw materials could adversely affect our business;
- we operate in highly competitive markets;
- we are exposed to currency exchange rate and interest rate fluctuations;
- we use derivatives to manage certain risks which has caused significant fluctuations in our operating results;
- we are subject to extensive environmental regulation and we could have environmental liabilities at our facilities;
- our business is subject to risks associated with climate change and social government responses thereto;

our operations require substantial capital and we may be unable to maintain adequate capital resources to provide for such requirements;

future acquisitions may result in additional risks and uncertainties in our business;

changes in credit ratings issued by nationally recognized statistical rating organizations could adversely affect our cost of financing and have an adverse effect on the market price of our securities;

- Project Blue Mill might not generate the results we expect;
- the actual timing, costs and benefits of the Celgar workforce reduction may differ from those currently expected;
- we are subject to risks related to our employees;
- we rely on German federal and state government grants and guarantees and participate in European statutory programs;
- we are dependent on key personnel;
- we may experience material disruptions to our production (including as a result of, among other things, planned and unplanned maintenance shutdowns);
- if our long-lived assets become impaired, we may be required to record non-cash impairment that could have a material impact on our results of operations;
- we may incur losses as a result of unforeseen or catastrophic events, including the emergence of a pandemic, terrorist attacks or natural disasters;
- our insurance coverage may not be adequate;
- we rely on third parties for transportation services; and
- the price of our common stock may be volatile.

Given these uncertainties, you should not place undue reliance on our forward-looking statements. The forgoing review of important factors is not exhaustive or necessarily in order of importance and should be read in conjunction with the risks and assumptions including those set forth in reports and other documents we have filed with or furnished to the SEC, including in our annual report on Form 10-K for the fiscal year ended December 31, 2012. We advise you that these cautionary remarks expressly qualify in their entirety all forward-looking statements attributable to us or persons acting on our behalf. Unless required by law, we do not assume any obligation to update forward-looking statements based on unanticipated events or changed expectations. However, you should carefully review the reports and other documents we file from time to time with the SEC.

Cyclical Nature of Business

Revenues

The pulp business is highly cyclical in nature and markets are characterized by periods of supply and demand imbalance, which in turn affects prices. Pulp markets are highly competitive and are sensitive to cyclical changes in the global economy, industry capacity and foreign exchange rates, all of which can have a significant influence on selling prices and our operating results. The length and magnitude of industry cycles have varied over time but generally reflect changes in macro-economic conditions and levels of industry capacity. Pulp is a commodity that is generally available from other producers. Because commodity products have few distinguishing qualities from producer to producer, competition is generally based upon price, which is generally determined by supply relative to demand.

Industry capacity can fluctuate as changing industry conditions can influence producers to idle production capacity or permanently close mills. In addition, to avoid substantial cash costs in idling or closing a mill, some producers will choose to operate at a loss, sometimes even a cash loss, which can prolong weak pricing environments due to oversupply. Oversupply of our products can also result from producers introducing new capacity in response to favorable pricing trends.

Demand for pulp has historically been determined primarily by general global macro-economic conditions and has been closely tied to overall business activity. From 2006 to mid-2008, pulp prices steadily improved. However, the global economic crisis in the latter half of 2008 resulted in a sharp decline of pulp prices from a high of $900 per ADMT to $635 per ADMT at the end of 2008. Pulp prices began to increase in the second half of 2009 and continued to increase to record levels through June of 2010, before declining slightly in the fourth quarter of 2010. Pulp prices again rebounded to record levels in the first half of 2011 but declined sharply in the latter part of the year, primarily due to economic uncertainty in Europe and credit tightening in China. Economic uncertainty in Europe and China, respectively, impacted both demand and prices. In 2012, list prices were on average approximately 15% lower than 2011. During the nine months ended September 30, 2013, pulp prices marginally increased in Europe, North America and China. As at September 30, 2013, list prices for NBSK pulp were approximately $880 per ADMT in Europe, $945 per ADMT in North America and $695 per ADMT in China.

Accordingly, prices for pulp are driven by many factors outside our control, and we have little influence over the timing and extent of price changes, which are often volatile. Because market conditions beyond our control determine the price for pulp, prices may fall below our cash production costs, requiring us to either incur short-term losses on product sales or cease production at one or more of our mills. Therefore, our profitability depends on managing our cost structure, particularly raw materials which represent a significant component of our operating costs and can fluctuate based upon factors beyond our control. If the prices of our products decline, or if prices for our raw materials increase, or both, our results of operations could be materially adversely affected.

Costs

Our production costs are influenced by the availability and cost of raw materials, energy and labor, and our plant efficiencies and productivity. Our main raw material is fiber in the form of wood chips and pulp logs. Wood chip and pulp log costs are primarily affected by the supply of, and demand for, lumber and pulp, which are both cyclical and, to a lesser extent, by increasing demand from renewable energy producers. Higher fiber costs could affect producer profit margins if they are unable to pass along price increases to pulp customers or purchasers of surplus energy. The state of lumber markets affects both the amount of sawmill residuals, such as chips, produced as a by-product of lumber and the level of timber harvesting, which provides us with pulp logs. Production costs also depend on the total volume of production. Lower operating rates during periods of cyclically low demand result in higher average production costs and lower margins.

Currency

The majority of our sales are in products quoted in U.S. dollars while most of our operating costs and expenses, other than those of the Celgar mill, are incurred in Euros. In addition, all of the products sold by the Celgar mill are quoted in U.S. dollars and the Celgar mill costs are primarily incurred in Canadian dollars. Our results of operations and financial condition are reported in Euros. As a result, our revenues are adversely affected by a decrease in the value of the U.S. dollar relative to the Euro and to the Canadian dollar. Such shifts in currencies relative to the Euro and the Canadian dollar reduce our operating margins and the cash flow available to fund our operations and to service our debt. This could have a material adverse effect on our business, financial condition, results of operations and cash flows.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks from changes in interest rates and foreign currency exchange rates, particularly the exchange rates between the Euro and the U.S. dollar and the Canadian dollar versus the U.S. dollar and the Euro. Changes in these rates may affect our results of operations and financial condition and, consequently, our fair value. We seek to manage these risks through internal risk management policies as well as the use of derivatives. We use derivatives to reduce or limit our exposure to interest rate and currency risks. We also use derivatives to reduce or limit our exposure to fluctuations in pulp prices. We use derivatives to reduce our potential losses or to augment our potential gains, depending on our management s perception of future economic events and developments. These types of derivatives are generally highly speculative in nature. They are also very volatile as they are highly leveraged given that margin requirements are relatively low in proportion to notional amounts.

Many of our strategies, including the use of derivatives, and the types of derivatives selected by us, are based on historical trading patterns and correlations and our management s expectations of future events. However, these strategies may not be effective in all market environments or against all types of risks. Unexpected market developments may affect our risk management strategies during this time, and unanticipated developments could impact our risk management strategies in the future. If any of the variety of instruments and strategies we utilize is not effective, we may incur significant losses.

All of our derivatives are marked to market at the end of each reporting period, and all unrealized gains and losses are recognized in earnings for a reporting period. We determine market valuations based primarily upon observable inputs including applicable yield curves.

During the nine months ended September 30, 2013, we recorded an unrealized gain of approximately 13.9 million on our outstanding interest rate derivative, compared to an unrealized loss of 0.6 million in the same period of 2012.

In November 2012, we entered into two fixed price pulp swap contracts with a bank. Under the terms of these contracts, 3,000 metric tonnes of pulp per month is fixed at prices which range from $880 to $890 per metric tonne. These contracts expire in December 2013.

We recorded a loss of approximately 1.8 million related to these swap contracts in the nine months ended September 30, 2013 and a gain of approximately 1.9 million in the nine months ended September 30, 2012.

We are also subject to some energy price risk, primarily for the natural gas and the electricity that our operations purchase.

ITEM 4. CONTROLS AND PROCEDURES
Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the *Securities Exchange Act of 1934*, as amended, referred to as the Exchange Act), as of the end of the period covered by this report. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Based on such evaluation, our principal executive officer and principal financial officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act.

It should be noted that any system of controls is based in part upon certain assumptions designed to obtain reasonable (and not absolute) assurance as to its effectiveness, and there can be no assurance that any design will succeed in achieving its stated goals.

Changes in Internal Controls

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to routine litigation incidental to our business, including those described in our latest annual report on Form 10-K for the fiscal year ended December 31, 2012. We do not believe that the outcome of such litigation will have a material adverse effect on our business or financial condition.

ITEM 1A. RISK FACTORS

As of September 30, 2013, there have been no material changes to the factors disclosed in Item 1A. Risk Factors in our latest annual report on Form 10-K for the fiscal year ended December 31, 2012 except with respect to the risk factor set forth below.

The actual timing, costs and benefits of the Celgar mill workforce reduction may differ from those currently expected.

On July 9, 2013, we announced that our Celgar mill intended to undertake a workforce reduction designed to, among other things, reduce the mill s fixed costs and improve its competitiveness. The Celgar workforce reduction initiative is subject to various risks, which could result in the actual timing, costs and benefits of the initiative differing from those currently anticipated. These risks and uncertainties include, among others that: we may not be able to implement the planned reduction in the timeframe currently planned; our costs related to such reduction may be higher than currently estimated; and unanticipated disruptions to the Celgar mill s operations may result in additional costs being incurred, anticipated benefits not being realized and may adversely impact the mill s operations.

ITEM 2. UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit No.	Description
4.1	Indenture, dated November 17, 2010, between Mercer International Inc. and Wells Fargo Bank, National Association, as trustee (filed as Exhibit 4.1 to Mercer International Inc. s Current Report on Form 8-K on July 23, 2013 and incorporated herein by reference)
10.1	Amendment Agreement, dated September 30, 2013, among Zellstoff Stendal GmbH, as Borrower, UniCredit Bank AG, as Arranger, Agent, Security Agent and Original Lender, the Lenders from time to time parties thereto, E & Z Industrie-Lösungen GmbH, Mercer International Inc. and Stendal Pulp Holding GmbH
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1*	Section 906 Certification of Chief Executive Officer
32.2*	Section 906 Certification of Chief Financial Officer
101	The following financial statements from the Company s Form 10-Q for the fiscal quarter ended September 30, 2013, formatted in XBRL: (i) Interim Consolidated Balance Sheets; (ii) Interim Consolidated Statements of Operations; (iii) Interim Consolidated Statements of Retained Earnings; (iv) Interim Consolidated Statements of Comprehensive Income; (v) Interim Consolidated Statements of Cash Flows; and (vi) Notes to Interim Consolidated Financial Statements.

* In accordance with Release 33-8212 of the Commission, these Certifications: (i) are furnished to the Commission and are not filed for the purposes of liability under the Securities Exchange Act of 1934, as amended; and (ii) are not to be subject to automatic incorporation by reference into any of the Company s registration statements filed under the Securities Act of 1933, as amended, for the purposes of liability thereunder or any offering memorandum, unless the Company specifically incorporates them by reference therein.

SIGNATURES

Pursuant to the requirements of the *Securities Exchange Act of 1934*, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MERCER INTERNATIONAL INC.

By: /s/ David M. Gandossi
David M. Gandossi
Secretary and Chief Financial Officer

Date: November 1, 2013