

MERCER INTERNATIONAL INC.  
Form 10-Q  
August 02, 2013

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 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)

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Washington  
(State or other jurisdiction of

47-0956945  
(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 ☒ 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 ☒ 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 ☒

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 ☒

The Registrant had 55,853,704 shares of common stock outstanding as at August 1, 2013.

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**MERCER INTERNATIONAL INC.**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE SIX MONTHS ENDED JUNE 30, 2013**

**(Unaudited)**

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QUARTERLY REPORT - PAGE 2

## MERCER INTERNATIONAL INC.

## INTERIM CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands of Euros)

	June 30, 2013	December 31, 2012
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	134,433	104,239
Receivables	97,028	110,087
Inventories (Note 2)	108,190	118,300
Prepaid expenses and other	12,830	7,907
Deferred income tax	3,812	4,465
Total current assets	356,293	344,998
Long-term assets		
Property, plant and equipment	788,818	808,878
Deferred note issuance and other	12,630	12,162
Deferred income tax	14,758	17,565
	816,206	838,605
Total assets	1,172,499	1,183,603
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and other	96,002	89,950
Pension and other post-retirement benefit obligations (Note 4)	780	813
Debt (Note 3)	44,346	45,662
Total current liabilities	141,128	136,425
Long-term liabilities		
Debt (Note 3)	680,087	665,741
Unrealized interest rate derivative losses (Note 8)	39,798	50,678
Pension and other post-retirement benefit obligations (Note 4)	31,158	32,141
Capital leases and other	13,599	13,936
Deferred income tax	6,892	5,757
	771,534	768,253
Total liabilities	912,662	904,678
<b>EQUITY</b>		
Shareholders' equity		
Share capital (Note 5)	248,923	248,371
Paid-in capital	(3,568)	(3,547)
Retained earnings	15,464	25,800
Accumulated other comprehensive income	14,585	25,181

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Total shareholders' equity	275,404	295,805
Noncontrolling interest (deficit)	(15,567)	(16,880)
Total equity	259,837	278,925
Total liabilities and equity	1,172,499	1,183,603

Commitments and contingencies (Note 10)

Subsequent events (Note 11)

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

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QUARTERLY REPORT - PAGE 3

## MERCER INTERNATIONAL INC.

## INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands of Euros, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues				
Pulp	193,659	186,036	373,779	385,475
Energy and chemicals	16,487	18,026	34,639	36,945
	210,146	204,062	408,418	422,420
Costs and expenses				
Operating costs	186,880	162,617	351,978	340,387
Operating depreciation and amortization	14,744	14,525	29,475	28,812
	8,522	26,920	26,965	53,221
Selling, general and administrative expenses	9,363	8,624	18,258	18,682
Operating income (loss)	(841)	18,296	8,707	34,539
Other income (expense)				
Interest expense	(13,139)	(13,863)	(26,287)	(27,996)
Gain on derivative instruments (Note 8)	5,293	1,343	10,113	2,219
Other income (expense)	6	(368)	(64)	(778)
Total other income (expense)	(7,840)	(12,888)	(16,238)	(26,555)
Income (loss) before income taxes	(8,681)	5,408	(7,531)	7,984
Income tax benefit (provision)				
Current	(192)	(6,281)	3,079	(6,337)
Deferred	(433)	4,016	(4,571)	3,340
Net income (loss)	(9,306)	3,143	(9,023)	4,987
Less: net income attributable to noncontrolling interest	(605)	(1,628)	(1,313)	(2,299)
Net income (loss) attributable to common shareholders	(9,911)	1,515	(10,336)	2,688
Net income (loss) per share attributable to common shareholders (Note 7)				
Basic and diluted	(0.18)	0.03	(0.19)	0.05

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)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Net income (loss)	(9,306)	3,143	(9,023)	4,987
Other comprehensive income (loss), net of taxes				
Foreign currency translation adjustments (net of tax effects of ( 285), 1,118, 289, 1,208)	(7,703)	(1,334)	(11,231)	813
Change in unrecognized losses and prior service costs related to defined benefit plans (net of tax effects of nil in all periods)	745	(485)	652	(336)
Unrealized gains (losses) on marketable securities, arising during the period (net of tax effects of nil in all periods)	(27)	(66)	(17)	2
Other comprehensive income (loss), net of taxes	(6,985)	(1,885)	(10,596)	479
Total comprehensive income (loss)	(16,291)	1,258	(19,619)	5,466
Comprehensive income attributable to noncontrolling interest	(605)	(1,628)	(1,313)	(2,299)
Comprehensive income (loss) attributable to common shareholders	(16,896)	(370)	(20,932)	3,167

**INTERIM CONSOLIDATED STATEMENTS OF RETAINED EARNINGS****(Unaudited)****(In thousands of Euros)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Net income (loss) attributable to common shareholders	(9,911)	1,515	(10,336)	2,688
Retained earnings, beginning of period	25,375	39,158	25,800	37,985
Retained earnings, end of period	15,464	40,673	15,464	40,673

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

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## MERCER INTERNATIONAL INC.

## INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands of Euros)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Cash flows from (used in) operating activities				
Net income (loss)	(9,306)	3,143	(9,023)	4,987
Adjustments to reconcile net income (loss) to cash flows from operating activities				
Unrealized gain on derivative instruments	(5,681)	(1,343)	(10,376)	(2,219)
Depreciation and amortization	14,810	14,588	29,604	28,938
Deferred income taxes	433	(4,016)	4,571	(3,340)
Stock compensation expense	306	(6)	573	862
Pension and other post-retirement expense, net of funding	212	(41)	333	(55)
Other	970	73	2,153	866
Changes in working capital				
Receivables	21,749	12,338	12,045	15,023
Inventories	2,147	(8,296)	7,893	3,442
Accounts payable and accrued expenses	(1,570)	805	9,027	3,454
Other	(5,708)	(86)	(6,490)	1,338
Net cash from (used in) operating activities	18,362	17,159	40,310	53,296
Cash flows from (used in) investing activities				
Purchase of property, plant and equipment	(10,982)	(9,838)	(22,377)	(18,303)
Proceeds on sale of property, plant and equipment	2	113	15	339
Proceeds on maturity of marketable securities		2,008		2,008
Net cash from (used in) investing activities	(10,980)	(7,717)	(22,362)	(15,956)
Cash flows from (used in) financing activities				
Repayment of debt		(1,584)	(20,545)	(11,710)
Proceeds from borrowings of debt	7,000		17,000	
Repayment of capital lease obligations	(401)	(448)	(1,101)	(1,059)
Proceeds from (repayment of) credit facilities, net	6,986	(3,759)	12,954	
Payment of note issuance costs				(1,621)
Proceeds from government grants	3,417	1,692	4,147	2,322
Net cash from (used in) financing activities	17,002	(4,099)	12,455	(12,068)
Effect of exchange rate changes on cash and cash equivalents	(615)	1,348	(209)	543
Net increase in cash and cash equivalents	23,769	6,691	30,194	25,815
Cash and cash equivalents, beginning of period	110,664	124,196	104,239	105,072
Cash and cash equivalents, end of period	134,433	130,887	134,433	130,887

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



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MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Unaudited)

(In thousands of Euros)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Supplemental disclosure of cash flow information				
Cash paid during the period for				
Interest	21,713	21,439	24,463	26,266
Income taxes	863	411	1,528	3,019
Supplemental schedule of non-cash investing and financing activities				
Acquisition of production and other equipment under capital lease obligations	245	774	415	774
Increase (decrease) in accounts payable and accrued purchases for property, plant and equipment	457	1,439	(2,442)	1,901
Increase (decrease) in receivables of government grants for long-term assets		(1,695)		(2,333)

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

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**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 to fairly present 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.

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## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

## Note 2. Inventories

	June 30, 2013	December 31, 2012
Raw materials	40,688	46,028
Finished goods	32,053	38,169
Spare parts and other	35,449	34,103
	108,190	118,300

## Note 3. Debt

Debt consists of the following:

	June 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)	432,907	452,907
Senior notes, interest at 9.50% accrued and payable semi-annually, unsecured (b)	218,571	215,670
Credit agreement with a lender with respect to a revolving credit facility of C\$40 million (c)	7,311	4,574
Term bank facility for a project at the Stendal mill of 17,000 (d)	17,000	
Loans payable to the noncontrolling shareholder of the Stendal mill (e)	37,556	36,620
Investment loan agreement with a lender with respect to a project at the Rosenthal mill of 4,351 (f)	1,088	1,632
Credit agreement with a bank with respect to a revolving credit facility of 25,000 (g)	10,000	
Credit agreement with a bank with respect to a revolving credit facility of 5,000 (h)		
	724,433	711,403
Less: current portion	(44,346)	(45,662)
Debt, less current portion	680,087	665,741

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

Matures	Amount
2013	22,174
2014	43,802
2015	47,584
2016	64,895
2017	545,978
Thereafter	

724,433

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 June 30, 2013, the Company was in compliance with the terms of the indenture.

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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 June 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 372,907 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 8 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 10(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 June 30, 2013, the DSRA balance was 32,992 and was not Fully Funded.

Pursuant to the terms of the Stendal Loan Facility and Project Blue Mill facility (Note 3(d)), the Stendal mill is required, among other things, to maintain a stipulated semi-annual leverage ratio of total debt to trailing 12-month EBITDA (as defined in the facilities) and a senior debt to EBITDA cover ratio (the Ratios ). The Stendal mill will report on its compliance with the Ratios on November 15, 2013 for the trailing 12-month period ended September 30, 2013 (formerly June 30, 2013). The Company will continue its discussions with the agent bank to obtain a satisfactory amendment of the Ratios.

- (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 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 ending 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.

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.

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MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

**Note 3. Debt (continued)**

- (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 June 30, 2013, this facility was accruing interest at a rate of approximately 3.25%, C\$10.0 million of this facility was drawn, C\$1.7 million was supporting letters of credit and approximately C\$17.6 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 June 30, 2013, the facility was fully drawn and accruing interest at a rate of approximately 3.61%. As part of the 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 June 30, 2013, the balance in the investment account was 6,053.
- (e) Loans of 26,760 payable by the Stendal mill to its noncontrolling shareholder bear interest at a rate of 7.00% 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 June 30, 2013, accrued interest on these loans was 10,796. 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 June 30, 2013, the balance outstanding was 1,088 and was accruing interest at a rate of 3.13%.
- (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 June 30, 2013, this facility was accruing interest at a rate of approximately 3.61%, 10,000 of this facility was drawn, approximately 1,300 of this facility was supporting bank guarantees leaving approximately 13,700 available.

(h)



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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 June 30, 2013, approximately 1,000 of this facility was supporting bank guarantees leaving approximately 4,000 available.

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## 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 six month periods ended June 30, 2013 totaled 405 and 902, respectively (2012 511 and 1,012).

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 six month periods ended June 30, 2013, the Company made contributions of 117 and 291, respectively (2012 159 and 320) to this plan.

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

	Three Months ended June 30,		2012	
	2013	Post-Retirement Benefits	Pension Benefits	Post-Retirement Benefits
Service cost	27	145	28	140
Interest cost	353	213	378	217
Expected return on plan assets	(411)		(406)	
Recognized net loss	277	22	280	1
Net periodic benefit cost	246	380	280	358

	Six Months ended June 30,		2012	
	2013	Post-Retirement Benefits	Pension Benefits	Post-Retirement Benefits
Service cost	53	291	55	278
Interest cost	708	427	751	431
Expected return on plan assets	(823)		(807)	
Recognized net loss	555	45	557	3
Net periodic benefit cost	493	763	556	712

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 six month periods ended June 30, 2013, the Company made contributions of 380 and 761, respectively (2012 463 and 940) to this plan.

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**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 June 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 six months ended June 30, 2013, the Company issued 38,000 restricted shares to directors of the Company.

*Share Repurchase Program*

In July 2012, the Company's Board of Directors authorized a share repurchase program (the Program) to repurchase up to approximately \$14.4 million of the Company's outstanding common shares from time to time over a period ending August 2013. During the six month period ended June 30, 2013 and the twelve month period ended December 31, 2012, the Company did not repurchase any of its common shares.

*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 June 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 June 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 six month period ended June 30, 2013 there were no changes to the issued and outstanding options, restricted stock rights, performance shares, PSUs or stock appreciation rights.

The following table summarizes restricted share activity during the period:

	<b>Number of Restricted Shares</b>
Outstanding at January 1, 2012	238,000
Granted	36,500
Vested	(78,000)
Outstanding at December 31, 2012	196,500
Granted	38,000

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Vested	(76,500)
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Outstanding at June 30, 2013	158,000
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## 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income (loss) attributable to common shareholders:				
Basic and diluted	(9,911)	1,515	(10,336)	2,688
Net income (loss) per share attributable to common shareholders:				
Basic and diluted	(0.18)	0.03	(0.19)	0.05
Weighted average number of common shares outstanding:				
Basic <sup>(1)</sup>	55,670,034	55,593,314	55,651,610	55,574,072
Effect of dilutive instruments:				
PSUs		267,013		329,737
Stock options		13,878		20,927
Diluted	55,670,034	55,874,205	55,651,610	55,924,736

(1) The basic weighted average number of shares excludes 158,000 restricted shares which have been issued, but have not vested as at June 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
PSUs	786,129		786,129	
Restricted shares	158,000	196,500	158,000	196,500
Stock options	175,000	75,000	175,000	75,000

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## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

**Note 8. 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 on derivative instruments in the Interim Consolidated Statement of Operations.

Derivative assets are presented in prepaid expenses and other, and 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 June 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.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Interest rate derivative contract	5,715	(276)	10,880	600
Pulp price derivative contracts	(422)	1,619	(767)	1,619
	5,293	1,343	10,113	2,219

## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

**Note 9. Financial Instruments**

The fair value of financial instruments is summarized as follows:

	June 30, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	134,433	134,433	104,239	104,239
Marketable securities	167	167	184	184
Receivables	97,028	97,028	110,087	110,087
Pulp price derivative contracts asset	245	245	745	745
Accounts payable and other	96,002	96,002	89,950	89,950
Debt	724,433	715,322	711,403	700,001
Interest rate derivative contract liability	39,798	39,798	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 investments, 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.

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



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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.

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## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

## Note 9. Financial Instruments (continued)

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:

Description	Fair Value Measurements at June 30, 2013			
	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Marketable securities	167			167
Pulp price derivative contracts		245		245
	167	245		412
<b>Liabilities</b>				
Interest rate derivative contract		39,798		39,798
Debt		702,177	13,145	715,322
		741,975	13,145	755,120
<b>Fair Value Measurements at December 31, 2012</b>				
Description	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Marketable securities	184			184
Pulp price derivative contracts		745		745
	184	745		929
<b>Liabilities</b>				
Interest rate derivative contract		50,678		50,678
Debt		687,184	12,817	700,001
		737,862	12,817	750,679

## Note 10. 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

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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 June 30, 2013, the Company had Guarantee Amount proceeds of 1,768 remaining in accounts payable and other.

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MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

**Note 10. Commitments and Contingencies (continued)**

- (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. The outcome of the appeal process is uncertain. 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.
- (d) As at June 30, 2013, the Company had entered into capital commitments of approximately 6,800 at the Stendal mill as part of Project Blue Mill.

**Note 11. Subsequent Events**

- (a) 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 12 months. In connection with implementing this work force reduction, the Company currently estimates that it will incur pre-tax charges in the range of approximately \$6.0 million to \$8.0 million 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. More than 85% of such charges are expected to be recognized by the end of 2013.
- (b) In July 2013, the Company issued \$50.0 million in aggregate principal amount of its Senior Notes. See Note 3(b) Debt for a description of the 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.

## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

**Note 12. 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 six months ended June 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**

	June 30, 2013			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
<b>ASSETS</b>				
Current assets				
Cash and cash equivalents	69,467	64,966		134,433
Receivables	49,674	47,354		97,028
Inventories	64,199	43,991		108,190
Prepaid expenses and other	7,883	4,947		12,830
Deferred income tax	2,178	1,634		3,812
Total current assets	193,401	162,892		356,293
Long-term assets				
Property, plant and equipment	327,107	461,711		788,818
Deferred note issuance and other	6,832	5,798		12,630
Deferred income tax	8,876	5,882		14,758
Due from unrestricted group	107,108		(107,108)	
Total assets	643,324	636,283	(107,108)	1,172,499
<b>LIABILITIES</b>				
Current liabilities				
Accounts payable and other	49,504	46,498		96,002
Pension and other post-retirement benefit obligations	780			780
Debt	1,088	43,258		44,346
Total current liabilities	51,372	89,756		141,128
Long-term liabilities				
Debt	235,883	444,204		680,087
Due to restricted group		107,108	(107,108)	
Unrealized interest rate derivative losses		39,798		39,798
Pension and other post-retirement benefit obligations	31,158			31,158
Capital leases and other	5,855	7,744		13,599
Deferred income tax	6,892			6,892
Total liabilities	331,160	688,610	(107,108)	912,662

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**EQUITY**

Total shareholders' equity (deficit)	312,164	(36,760)		275,404
Noncontrolling interest (deficit)		(15,567)		(15,567)
Total liabilities and equity	643,324	636,283	(107,108)	1,172,499

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## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

## Note 12. Restricted Group Supplemental Disclosure (continued)

## Combined Condensed Balance Sheets

	December 31, 2012			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
<b>ASSETS</b>				
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
<b>LIABILITIES</b>				
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
<b>EQUITY</b>				
Total shareholders' equity (deficit)	335,353	(39,548)		295,805

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Noncontrolling interest (deficit)		(16,880)		(16,880)
Total liabilities and equity	644,119	641,795	(102,311)	1,183,603

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## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

## Note 12. Restricted Group Supplemental Disclosure (continued)

## Combined Condensed Statements of Operations

	Restricted Group	Three Months Ended June 30, 2013 Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	105,541	88,118		193,659
Energy and chemicals	6,040	10,447		16,487
	111,581	98,565		210,146
Operating costs	103,558	83,322		186,880
Operating depreciation and amortization	8,258	6,486		14,744
Selling, general and administrative expenses	5,644	3,719		9,363
	117,460	93,527		210,987
Operating income (loss)	(5,879)	5,038		(841)
Other income (expense)				
Interest expense	(5,880)	(8,907)	1,648	(13,139)
Gain (loss) on derivative instruments	(422)	5,715		5,293
Other income (expense)	1,620	34	(1,648)	6
Total other income (expense)	(4,682)	(3,158)		(7,840)
Income (loss) before income taxes	(10,561)	1,880		(8,681)
Income tax benefit (provision)	(611)	(14)		(625)
Net income (loss)	(11,172)	1,866		(9,306)
Less: net income attributable to noncontrolling interest		(605)		(605)
Net income (loss) attributable to common shareholders	(11,172)	1,261		(9,911)

  

	Restricted Group	Three Months Ended June 30, 2012 Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	103,745	82,291		186,036
Energy and chemicals	6,460	11,566		18,026

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	110,205	93,857	204,062
Operating costs	94,762	67,855	162,617
Operating depreciation and amortization	7,807	6,718	14,525
Selling, general and administrative expenses	5,406	3,218	8,624
	107,975	77,791	185,766
Operating income (loss)	2,230	16,066	18,296
Other income (expense)			
Interest expense	(5,934)	(9,312)	1,383
Gain (loss) on derivative instruments	1,619	(276)	1,343
Other income (expense)	915	100	(1,383)
Total other income (expense)	(3,400)	(9,488)	(12,888)
Income (loss) before income taxes	(1,170)	6,578	5,408
Income tax benefit (provision)	(1,398)	(867)	(2,265)
Net income (loss)	(2,568)	5,711	3,143
Less: net income attributable to noncontrolling interest		(1,628)	(1,628)
Net income (loss) attributable to common shareholders	(2,568)	4,083	1,515

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## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

## Note 12. Restricted Group Supplemental Disclosure (continued)

## Combined Condensed Statements of Operations

	Restricted Group	Six Months Ended June 30, 2013 Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	205,781	167,998		373,779
Energy and chemicals	13,130	21,509		34,639
	218,911	189,507		408,418
Operating costs	193,081	158,897		351,978
Operating depreciation and amortization	16,449	13,026		29,475
Selling, general and administrative expenses	11,360	6,898		18,258
	220,890	178,821		399,711
Operating income (loss)	(1,979)	10,686		8,707
Other income (expense)				
Interest expense	(11,746)	(17,837)	3,296	(26,287)
Gain (loss) on derivative instruments	(767)	10,880		10,113
Other income (expense)	3,155	77	(3,296)	(64)
Total other income (expense)	(9,358)	(6,880)		(16,238)
Income (loss) before income taxes	(11,337)	3,806		(7,531)
Income tax benefit (provision)	(1,627)	135		(1,492)
Net income (loss)	(12,964)	3,941		(9,023)
Less: net income attributable to noncontrolling interest		(1,313)		(1,313)
Net income (loss) attributable to common shareholders	(12,964)	2,628		(10,336)

	Restricted Group	Six Months Ended June 30, 2012 Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	213,634	171,841		385,475
Energy and chemicals	14,451	22,494		36,945

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	228,085	194,335	422,420
Operating costs	193,098	147,289	340,387
Operating depreciation and amortization	15,447	13,365	28,812
Selling, general and administrative expenses	11,927	6,755	18,682
	220,472	167,409	387,881
Operating income (loss)	7,613	26,926	34,539
Other income (expense)			
Interest expense	(11,744)	(18,976)	2,724
Gain (loss) on derivative instruments	1,619	600	2,219
Other income (expense)	1,740	206	(2,724)
			(778)
Total other income (expense)	(8,385)	(18,170)	(26,555)
Income (loss) before income taxes	(772)	8,756	7,984
Income tax benefit (provision)	(2,113)	(884)	(2,997)
Net income (loss)	(2,885)	7,872	4,987
Less: net income attributable to noncontrolling interest		(2,299)	(2,299)
Net income (loss) attributable to common shareholders	(2,885)	5,573	2,688

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## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

## Note 12. Restricted Group Supplemental Disclosure (continued)

## Combined Condensed Statements of Cash Flows

	Three Months Ended June 30, 2013		
	Restricted Group	Unrestricted Subsidiaries	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss)	(11,172)	1,866	(9,306)
Adjustments to reconcile net income (loss) to cash flows from operating activities			
Unrealized loss (gain) on derivative instruments	34	(5,715)	(5,681)
Depreciation and amortization	8,324	6,486	14,810
Deferred income taxes	433		433
Stock compensation expense	306		306
Pension and other post-retirement expense, net of funding	212		212
Other	290	680	970
Changes in working capital			
Receivables	18,863	2,886	21,749
Inventories	5,303	(3,156)	2,147
Accounts payable and accrued expenses	(1,879)	309	(1,570)
Other <sup>(1)</sup>	(6,926)	1,218	(5,708)
Net cash from (used in) operating activities	13,788	4,574	18,362
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(2,602)	(8,380)	(10,982)
Proceeds on sale of property, plant and equipment		2	2
Net cash from (used in) investing activities	(2,602)	(8,378)	(10,980)
Cash flows from (used in) financing activities			
Proceeds from borrowings of debt		7,000	7,000
Repayment of capital lease obligations	(122)	(279)	(401)
Proceeds from (repayment of) credit facilities, net	6,986		6,986
Proceeds from government grants		3,417	3,417
Net cash from (used in) financing activities	6,864	10,138	17,002
Effect of exchange rate changes on cash and cash equivalents	(615)		(615)
Net increase in cash and cash equivalents	17,435	6,334	23,769
Cash and cash equivalents, beginning of period	52,032	58,632	110,664

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Cash and cash equivalents, end of period	69,467	64,966	134,433
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(1) Includes intercompany related transactions.

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## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

## Note 12. Restricted Group Supplemental Disclosure (continued)

## Combined Condensed Statements of Cash Flows

	Three Months Ended June 30, 2012		
	Restricted Group	Unrestricted Subsidiaries	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss)	(2,568)	5,711	3,143
Adjustments to reconcile net income (loss) to cash flows from operating activities			
Unrealized loss (gain) on derivative instruments	(1,619)	276	(1,343)
Depreciation and amortization	7,870	6,718	14,588
Deferred income taxes	1,240	(5,256)	(4,016)
Stock compensation expense	(6)		(6)
Pension and other post-retirement expense, net of funding	(41)		(41)
Other	(535)	608	73
Changes in working capital			
Receivables	7,833	4,505	12,338
Inventories	(1,765)	(6,531)	(8,296)
Accounts payable and accrued expenses	(3,155)	3,960	805
Other <sup>(1)</sup>	(1,514)	1,428	(86)
Net cash from (used in) operating activities	5,740	11,419	17,159
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(8,815)	(1,023)	(9,838)
Proceeds on sale of property, plant and equipment	51	62	113
Proceeds on maturity of marketable securities	2,008		2,008
Net cash from (used in) investing activities	(6,756)	(961)	(7,717)
Cash flows from (used in) financing activities			
Repayment of debt	(1,584)		(1,584)
Repayment of capital lease obligations	(180)	(268)	(448)
Proceeds from (repayment of) credit facilities, net	(3,759)		(3,759)
Proceeds from government grants	1,692		1,692
Net cash from (used in) financing activities	(3,831)	(268)	(4,099)
Effect of exchange rate changes on cash and cash equivalents	1,348		1,348
Net increase (decrease) in cash and cash equivalents	(3,499)	10,190	6,691
Cash and cash equivalents, beginning of period	53,595	70,601	124,196

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Cash and cash equivalents, end of period	50,096	80,791	130,887
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(1) Includes intercompany related transactions.

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## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

## Note 12. Restricted Group Supplemental Disclosure (continued)

## Combined Condensed Statements of Cash Flows

	Six Months Ended June 30, 2013		
	Restricted Group	Unrestricted Subsidiaries	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss)	(12,964)	3,941	(9,023)
Adjustments to reconcile net income (loss) to cash flows from operating activities			
Unrealized loss (gain) on derivative instruments	504	(10,880)	(10,376)
Depreciation and amortization	16,578	13,026	29,604
Deferred income taxes	1,424	3,147	4,571
Stock compensation expense	573		573
Pension and other post-retirement expense, net of funding	333		333
Other	703	1,450	2,153
Changes in working capital			
Receivables	10,524	1,521	12,045
Inventories	8,370	(477)	7,893
Accounts payable and accrued expenses	8,626	401	9,027
Other <sup>(1)</sup>	(8,640)	2,150	(6,490)
Net cash from (used in) operating activities	26,031	14,279	40,310
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(5,247)	(17,130)	(22,377)
Proceeds on sale of property, plant and equipment	13	2	15
Net cash from (used in) investing activities	(5,234)	(17,128)	(22,362)
Cash flows from (used in) financing activities			
Repayment of debt	(545)	(20,000)	(20,545)
Proceeds from borrowings of debt		17,000	17,000
Repayment of capital lease obligations	(244)	(857)	(1,101)
Proceeds from (repayment of) credit facilities, net	12,954		12,954
Proceeds from government grants		4,147	4,147
Net cash from (used in) financing activities	12,165	290	12,455
Effect of exchange rate changes on cash and cash equivalents	(209)		(209)
Net increase (decrease) in cash and cash equivalents	32,753	(2,559)	30,194
Cash and cash equivalents, beginning of period	36,714	67,525	104,239

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Cash and cash equivalents, end of period	69,467	64,966	134,433
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(1) Includes intercompany related transactions.

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## MERCER INTERNATIONAL INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

## Note 12. Restricted Group Supplemental Disclosure (continued)

## Combined Condensed Statements of Cash Flows

	Six Months Ended June 30, 2012		
	Restricted Group	Unrestricted Subsidiaries	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss)	(2,885)	7,872	4,987
Adjustments to reconcile net income (loss) to cash flows from operating activities			
Unrealized loss (gain) on derivative instruments	(1,619)	(600)	(2,219)
Depreciation and amortization	15,573	13,365	28,938
Deferred income taxes	1,916	(5,256)	(3,340)
Stock compensation expense	862		862
Pension and other post-retirement expense, net of funding	(55)		(55)
Other	(477)	1,343	866
Changes in working capital			
Receivables	5,723	9,300	15,023
Inventories	2,253	1,189	3,442
Accounts payable and accrued expenses	2,380	1,074	3,454
Other <sup>(1)</sup>	(7,988)	9,326	1,338
Net cash from (used in) operating activities	15,683	37,613	53,296
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(13,033)	(5,270)	(18,303)
Proceeds on sale of property, plant and equipment	237	102	339
Proceeds on maturity of marketable securities	2,008		2,008
Net cash from (used in) investing activities	(10,788)	(5,168)	(15,956)
Cash flows from (used in) financing activities			
Repayment of debt	(2,127)	(9,583)	(11,710)
Repayment of capital lease obligations	(366)	(693)	(1,059)
Payment of note issuance costs		(1,621)	(1,621)
Proceeds from government grants	2,322		2,322
Net cash from (used in) financing activities	(171)	(11,897)	(12,068)
Effect of exchange rate changes on cash and cash equivalents	543		543
Net increase in cash and cash equivalents	5,267	20,548	25,815
Cash and cash equivalents, beginning of period	44,829	60,243	105,072

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Cash and cash equivalents, end of period	50,096	80,791	130,887
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(1) Includes intercompany related transactions.

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**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 mean Mercer International Inc. and its subsidiaries; (ii) references to Mercer Inc. mean the Company excluding its subsidiaries; (iii) information is provided as of June 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 refers to 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 74.9% owned subsidiary, Stendal, which 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 six months ended June 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, with the majority of employees leaving the mill over the next 12 months, in order to improve its competitiveness with other pulp producers. This action is being taken to reduce the mill's fixed costs. We currently estimate incurring pre-tax charges of approximately \$6.0 million to \$8.0 million for severance and other personnel related expenses in connection with such reduction. Over 85% of these charges are expected to be recognized by the end of 2013. We currently estimate that our Celgar mill will realize approximately \$8.0 million to \$10.0 million in annual pre-tax cost savings once the workforce restructuring has been fully implemented. Based upon our planned workforce reduction schedule, we currently expect to realize approximately 80% of such annual cost savings in 2014.

***Current Market Environment***

Pulp list prices were up marginally in the second quarter of 2013. At the end of the second quarter of 2013, list prices in Europe were approximately \$860 per ADMT and in North America and China were approximately \$950 and \$690 per ADMT, respectively.

We currently expect demand and pricing to trend upwards in the latter part of 2013. Annual maintenance shuts by producers should cause NBSK pulp prices to continue to gradually increase in the medium term. We believe supply and demand levels through the summer should benefit from significant producer maintenance downtime during the summer months. In addition, the announced closure of a Norwegian mill (Tofte) and new tissue capacity coming online in China should keep supply and demand in balance.

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**Summary Financial Highlights**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands, other than per share amounts)			
Pulp revenues	193,659	186,036	373,779	385,475
Energy and chemical revenues	16,487	18,026	34,639	36,945
Operating income (loss)	(841)	18,296	8,707	34,539
Gain on derivative instruments	5,293	1,343	10,113	2,219
Income tax benefit (provision)	(625)	(2,265)	(1,492)	(2,997)
Net income (loss) <sup>(1)</sup>	(9,911)	1,515	(10,336)	2,688
Net income (loss) per share <sup>(1)(2)</sup>	(0.18)	0.03	(0.19)	0.05

(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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Consolidated</b>				
Pulp production ( 000 ADMTs)	349.5	365.0	710.7	745.4
Scheduled production downtime ( 000 ADMTs)	16.0	22.6	16.0	22.6
Scheduled production downtime (days)	11	23	11	23
Pulp sales ( 000 ADMTs)	368.3	349.2	724.9	734.0
Average NBSK pulp list prices in Europe (\$/ADMT) <sup>(1)</sup>	857	837	844	837
Average NBSK pulp list prices in Europe ( /ADMT)	656	652	643	645
Average pulp sales realizations ( /ADMT) <sup>(3)</sup>	520	526	509	519
Energy production ( 000 MWh)	405.8	425.4	830.2	861.7
Energy sales ( 000 MWh)	167.5	182.7	341.1	365.1
Average energy sales realizations ( /MWh)	83	81	86	85
<b>Average Spot Currency Exchange Rates</b>				
/ \$)	0.7655	0.7795	0.7619	0.7710
C\$ / \$( <sup>(3)</sup> )	1.0230	1.0102	1.0160	1.0056
C\$ / ( <sup>(4)</sup> )	1.3374	1.2959	1.3346	1.3044

(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 June 30, 2013 Compared to Three Months Ended June 30, 2012**

Total revenues for the three months ended June 30, 2013 increased by approximately 3% to 210.1 million from 204.1 million in the same period in 2012, due to higher pulp revenues.

Pulp revenues for the three months ended June 30, 2013 increased to 193.7 million from 186.0 million in the comparative quarter of 2012, primarily due to higher pulp sales volumes, partially offset by a weaker U.S. dollar relative to the Euro. The U.S. dollar decreased versus the Euro in the current quarter, compared to the same quarter of last year.

Energy and chemical revenues decreased by approximately 8% to 16.5 million in the second quarter from 18.0 million in the same quarter last year, primarily as a result of lower pulp production.

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Average list prices for NBSK pulp in Europe were approximately \$857 ( 656) per ADMT in the current quarter, compared to approximately \$837 ( 652) per ADMT in the same quarter last year. In the second quarter of 2013, average pulp sales realizations marginally decreased by approximately 1% to 520 per ADMT from approximately 526 per ADMT in the same quarter last year, primarily due to a weaker U.S. dollar relative to the Euro, partially offset by higher pulp prices.

Pulp production decreased by approximately 4% to 349,502 ADMTs in the current quarter from 365,047 ADMTs in the same quarter of 2012, primarily due to decreased pulp production at our Celgar mill. During the second quarter of 2013, our Celgar mill took its annual scheduled major maintenance shutdown. As a result of a combination of a lightning strike at the mill and equipment and execution issues, the shutdown which was planned for 11 days took 15 days instead. Further, the start-up of the mill was slower than budgeted. The shutdown and slower start-up resulted in a loss of approximately 30,300 ADMTs of NBSK pulp production (of which approximately 14,300 ADMTs was unplanned) and a consequential loss of energy production. The shutdown had a negative impact of approximately 11.0 million on our operating results for the second quarter of 2013.

We believe the issues with the Celgar maintenance shutdown were isolated and the mill is performing well and operating at pre-shutdown levels. We believe our inventory levels are adequate and anticipate no material customer issues from this event.

Pulp sales volumes increased by approximately 5% to 368,285 ADMTs in the current quarter from 349,177 ADMTs in the comparative quarter, primarily due to higher sales to Europe and China.

Costs and expenses in the second quarter of 2013 increased by approximately 14% to 211.0 million from 185.8 million in the comparative period of 2012, primarily due to higher sales volumes, fiber costs and costs associated with the Celgar mill maintenance shutdown.

In the second quarter of 2013, operating depreciation and amortization marginally increased to 14.7 million from 14.5 million in the same quarter last year. Selling, general and administrative expenses were 9.4 million in the second quarter of 2013, compared to 8.6 million in the second quarter of 2012.

Transportation costs marginally increased to 17.6 million in the second quarter of 2013 from 17.4 million in the second quarter of 2012, primarily due to flood conditions in Germany as trucks and trains were forced to re-route over longer distances.

On average, our per unit fiber costs in the current quarter increased by approximately 6% from the same period in 2012. During the second quarter of 2013, fiber costs at our German mills were higher than the comparative period in 2012. Increased demand from the European pellet and board producers and sawmills and an under supply of sawlogs kept fiber prices at relatively high levels in the current quarter. Fiber costs at our Celgar mill decreased as a result of increased sawmill activity in the region. Going forward this year, we currently expect fiber costs at our German mills to marginally increase and then stabilize, whereas we expect fiber costs at our Celgar mill to decrease moderately.

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For the second quarter of 2013, we reported an operating loss of 0.8 million, compared to operating income of 18.3 million in the comparative quarter of 2012, primarily due to the negative impact of the Celgar mill shutdown, higher fiber costs and the weaker U.S. dollar relative to the Euro.

Interest expense in the second quarter of 2013 decreased to 13.1 million from 13.9 million in the comparative quarter of 2012, primarily due to lower debt levels associated with the Stendal mill in the second quarter of 2013.

We recorded a net derivative gain of 5.3 million, which includes a 0.4 million loss related to fixed price pulp swap contracts entered into in the fourth quarter of 2012 and an unrealized gain of approximately 5.7 million on the mark to market adjustment of our Stendal mill's interest rate derivative, compared to a net derivative gain of 1.3 million in the same quarter of last year.

During the current quarter, we recorded a net income tax expense of 0.6 million, compared to 2.3 million in the same quarter of 2012.

The noncontrolling shareholder's interest in the Stendal mill's net income in the second quarter of 2013 was 0.6 million, compared to 1.6 million in the same quarter last year.

We reported a net loss attributable to common shareholders of 9.9 million, or 0.18 per basic and diluted share, for the second quarter of 2013, which included a total net non-cash unrealized gain of 5.7 million on the fixed price pulp swaps and Stendal interest rate derivative, and the negative impact of approximately 11.0 million related to the Celgar mill's maintenance shutdown. In the second quarter of 2012, net income attributable to common shareholders was 1.5 million, or 0.03 per basic and diluted share, which included a net non-cash unrealized gain of 1.3 million on the Stendal interest rate derivative and fixed price pulp swaps.

Operating EBITDA in the second quarter of 2013 was 14.0 million, compared to 32.9 million in the second quarter of 2012. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. Management uses Operating EBITDA as a benchmark measurement of its own operating results, and as a benchmark relative to its competitors. Management considers it to be a meaningful supplement to operating income (loss) as a performance measure primarily because depreciation expense and non-recurring capital asset impairment charges are not an actual cash cost, and depreciation expense varies widely from company to company in a manner that management considers largely independent of the underlying cost efficiency of their operating facilities. In addition, we believe Operating EBITDA is commonly used by securities analysts, investors and other interested parties to evaluate our financial performance.

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.

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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 income (loss) attributable to common shareholders to operating income (loss) and Operating EBITDA for the periods indicated:

	<b>Three Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in thousands)</b>	
Net income (loss) attributable to common shareholders	(9,911)	1,515
Net income attributable to noncontrolling interest	605	1,628
Income tax provision	625	2,265
Interest expense	13,139	13,863
Gain on derivative instruments	(5,293)	(1,343)
Other expense (income)	(6)	368
Operating income (loss)	(841)	18,296
Add: Depreciation and amortization	14,810	14,588
Operating EBITDA	13,969	32,884

#### *Six Months Ended June 30, 2013 Compared to Six Months Ended June 30, 2012*

Total revenues for the six months ended June 30, 2013 decreased by approximately 3% to 408.4 million from 422.4 million in the same period in 2012, due to lower pulp and energy and chemical revenues.

Pulp revenues for the six months ended June 30, 2013 decreased to 373.8 million from 385.5 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 1% weaker versus the Euro in the first half of 2013, compared to the same period of last year.

Energy and chemical revenues decreased by approximately 6% to 34.6 million in the first half of 2013 from 36.9 million in the same period last year, primarily as a result of lower pulp production.

Average list prices for NBSK pulp in Europe were approximately \$844 ( 643) per ADMT in the first half of 2013, compared to approximately \$837 ( 645) per ADMT in the same period last year. In the first half of 2013, average pulp sales realizations decreased by approximately 2% to 509 per ADMT from approximately 519 per ADMT in the same period last year, primarily due to the impact of a weaker U.S. dollar versus the Euro.

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Pulp production decreased by approximately 5% to 710,666 ADMTs in the first half of 2013 from 745,389 ADMTs in the same period of 2012, primarily due to decreased pulp production at our Celgar mill. We had 15 days of maintenance downtime at our Celgar mill in the first half of 2013, which, together with a slower startup, resulted in a loss of approximately 30,300 ADMTs of NBSK pulp production.

Pulp sales volumes decreased by approximately 1% to 724,945 ADMTs in the first half of 2013 from 734,003 ADMTs in the comparative period of 2012, primarily due to lower sales to the United States.

Costs and expenses in the first half of 2013 increased by 3% to 399.7 million from 387.9 million in the comparative period of 2012, primarily due to higher fiber costs at our German mills and costs associated with the Celgar maintenance shutdown.

In the first half of 2013, operating depreciation and amortization marginally increased to 29.5 million from 28.8 million in the same period last year. Selling, general and administrative expenses were 18.3 million in the first half of 2013, compared to 18.7 million in the same period of 2012.

Transportation costs decreased to 34.4 million in the first half of 2013 from 35.4 million in the same period of 2012, primarily due to lower pulp sales volumes, partially offset by increased logistics costs related to flooding in Germany in the second quarter of 2013.

On average, our per unit fiber costs in the first six months of 2013 increased by approximately 2% from the same period in 2012. During the first half of 2013, fiber costs at our German mills were higher than the comparative period in 2012. Increased 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 increased sawmill activity in the region. Going forward this year, we currently expect fiber costs at our German mills to marginally increase and then stabilize, whereas we expect fiber costs at our Celgar mill to continue to decrease moderately.

For the first half of 2013, operating income decreased to 8.7 million from 34.5 million in the comparative period of 2012, primarily due to the combined effect of the Celgar mill's maintenance shutdown and lower pulp sales volumes and higher fiber costs.

Interest expense in the first half of 2013 decreased to 26.3 million from 28.0 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 10.1 million, which includes a 0.8 million loss related to fixed price pulp swap contracts entered into in the fourth quarter of 2012 and an unrealized gain of approximately 10.9 million on the mark to market adjustment of our Stendal mill's interest rate derivative, compared to a derivative gain of 2.2 million in the same period of last year.

During the six months ended June 30, 2013, we recorded a net income tax expense of 1.5 million, compared to 3.0 million in the same period of 2012.

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The noncontrolling shareholder's interest in the Stendal mill's income in the first half of 2013 was 1.3 million, compared to 2.3 million in the same period last year.

We reported a net loss attributable to common shareholders of 10.3 million, or 0.19 per basic and diluted share, for the first half of 2013, which included a net non-cash unrealized gain of 10.4 million on the fixed price pulp swaps and Stendal interest rate derivative, more than offset by a negative impact of approximately 11.0 million related to the Celgar maintenance shutdown and a non-cash charge for stock compensation of 0.6 million. In the first half of 2012, net income attributable to common shareholders was 2.7 million, or 0.05 per basic and diluted share, which included a non-cash unrealized gain of 2.2 million on the fixed price pulp swaps and Stendal interest rate derivative, partially offset by a non-cash charge for stock compensation of 0.9 million.

Operating EBITDA in the first half of 2013 was 38.3 million, compared to 63.5 million in the first half 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 results for the three months ended June 30, 2013 for additional information relating to such limitations of Operating EBITDA.

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

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in thousands)</b>	
Net income (loss) attributable to common shareholders	(10,336)	2,688
Net income attributable to noncontrolling interest	1,313	2,299
Income tax provision	1,492	2,997
Interest expense	26,287	27,996
Gain on derivative instruments	(10,113)	(2,219)
Other expense (income)	64	778
<b>Operating income</b>	<b>8,707</b>	<b>34,539</b>
Add: Depreciation and amortization	29,604	28,938
<b>Operating EBITDA</b>	<b>38,311</b>	<b>63,477</b>

## Liquidity and Capital Resources

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

	<b>As at June 30, 2013</b>	<b>As at December 31, 2012</b>
	<b>(in thousands)</b>	
<b>Financial Position</b>		
Cash and cash equivalents	134,433	104,239
Working capital	215,165	208,573
Total assets	1,172,499	1,183,603
Long-term liabilities	771,534	768,253
Total equity	259,837	278,925

As at June 30, 2013, we had approximately 17.7 million and C\$17.6 million available under our Rosenthal and Celgar revolving facilities, respectively.

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As at June 30, 2013, our cash and cash equivalents increased to 134.4 million from 104.2 million and working capital had increased to 215.2 million from 208.6 million at the end of 2012.

On July 22, 2013, we completed our registered public offering of \$50.0 million aggregate principal amount of additional 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.

#### ***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 449.9 million in total principal outstanding at June 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. The Stendal Facilities require the Stendal mill, among other things, to maintain a stipulated semi-annual leverage ratio and a debt coverage ratio (the Ratios) and previously report on compliance with such Ratios on September 30, 2013 for the trailing 12-month period ended June 30, 2013.

We have had ongoing discussions with the agent bank under the Stendal Facilities to obtain a satisfactory amendment and/or waiver of the Ratios to provide greater flexibility for the Stendal mill. On June 26, 2013, Stendal and the agent bank for the lenders agreed upon a non-binding term sheet which will provide the mill with greater covenant flexibility and the mill engaged the agent bank pursuant to a mandate agreement to seek lender approval to implement the same. Pursuant to the term sheet, concurrent with a successful amendment of the Stendal Facilities thereunder, we have agreed to invest \$20.0 million into Stendal as additional capital. The term sheet is subject to customary conditions and approvals, including lender approval, German governmental approval, our board approval, Stendal shareholder approval and entering into satisfactory definitive legal agreements.

Subsequent to entering into the term sheet, the agent has advised that the lenders agreed to have: (i) the Ratios cover the trailing 12-month period ending on September 30, 2013, instead of June 30, 2013; and (ii) the Stendal mill report on its compliance with the Ratios revised as aforesaid on November 15, 2013.

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Currently, based upon our discussions with the agent bank to date, the limited nature of the requested amendment, the Stendal mill's current liquidity (cash on hand, as at June 30, 2013 of approximately \$65.0 million, of which \$33.0 million is in a debt service reserve account) and the governmental guarantees, we believe we will be able to conclude a satisfactory amendment with Stendal's lenders in the third quarter of 2013; however, we cannot assure you of a successful outcome.

In the event that the Stendal mill is not in compliance with the revised Ratios when they are reported on November 15, 2013, we have the right to cure any breach by providing additional capital to Stendal within 20 business days of being notified of such breach by the lenders. If the Stendal mill is not in compliance with such revised Ratios as aforesaid, and is unable to secure a satisfactory amendment and/or waiver of the Ratios and we do not cure the breach by providing additional capital to Stendal, the breach would constitute an event of default under the Stendal Facilities. If such event of default occurs and after careful consideration of the reasonable concerns of Stendal or if the stipulated majority of the lenders have reasonably determined that such default has caused Stendal's ability to perform its obligations thereunder to be materially impaired, the lenders may provide notice cancelling and accelerating the Stendal Facilities and demanding full payment thereof. In the current circumstances, we do not believe Stendal's lenders would be permitted to accelerate and cancel such loan facilities based upon a failure to satisfy the Ratios; however, we cannot assure you of the same.

If Stendal's lenders did accelerate and cancel the Stendal Facilities, this would have a material adverse effect on the Stendal mill and our consolidated financial condition, results of operations and liquidity.

#### ***Celgar Working Capital Facility***

On May 2, 2013, our Celgar mill entered into a Second Amended and Restated Credit Agreement (the "Second Amended Credit Agreement") with the lenders party thereto relating to its C\$40.0 million revolving working capital credit facility (the "Celgar Working Capital Facility"). The Second Amended Credit Agreement amended and restated the Amended and Restated Credit Agreement, dated November 27, 2009, by and among our Celgar mill, the lenders party thereto and CIT Business Credit Canada Inc., as agent.

The Second Amended Credit Agreement extends the maturity of the Celgar Working Capital Facility to May 2, 2016. The Celgar Working Capital Facility is available by way of: (i) Canadian and U.S. denominated advances which bear interest at a designated prime rate plus 0.25% for Canadian advances and at a designated base rate plus 0.25% per annum for U.S. advances; (ii) banker's acceptance equivalent loans which will be subject to a discount rate and an acceptance fee calculated on the face amount of such loans at a rate equal to the applicable Canadian dollar bankers' acceptance rate plus 1.75% per annum; and/or (iii) LIBOR advances which bear interest at the applicable LIBOR plus 1.75% per annum. The Celgar Working Capital Facility also incorporates a C\$3.0 million letter of credit sub-line. Celgar is also required to pay a 0.35% per annum standby fee monthly in arrears on any unutilized portion of the revolving facility. Availability of drawdowns under the facility is subject to a borrowing base limit that is based upon the Celgar mill's eligible accounts receivable and inventory levels from time to time. The Celgar Working Capital Facility is secured by, among other things, a first fixed charge on the current assets of Celgar.

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As at June 30, 2013, C\$17.6 million of funds were available under the Celgar Working Capital Facility.

***Rosenthal Revolving Credit Facility***

In the second quarter of 2013, our Rosenthal mill amended its revolving credit facility to increase it from 3.5 million to 5.0 million. The revolving credit facility for the Rosenthal mill bears interest at the rate of Euribor plus 3.5% and it matures in December 2015. As at June 30, 2013, approximately 1.0 million of this facility was supporting bank guarantees leaving approximately 4.0 million available.

In addition, our Rosenthal mill has a 25.0 million working capital facility that matures in October 2016.

***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 40.3 million in the six months ended June 30, 2013 from 53.3 million in the comparative period of 2012, primarily due to weaker operating performance. An increase in accounts payable and accrued expenses provided cash of 9.0 million, compared to 3.5 million in the same period of 2012. A decrease in inventories provided cash of 7.9 million in the six months ended June 30, 2013, compared to 3.4 million in the same period of 2012. A decrease in receivables provided cash of 12.0 million in the six months ended June 30, 2013, compared to 15.0 million in the same period of 2012.

***Cash Flows from Investing Activities.*** Investing activities in the six months ended June 30, 2013 used cash of 22.4 million, compared to using cash of 16.0 million in the same period of 2012. Capital expenditures in the six months ended June 30, 2013 used cash of 22.4 million, compared to 18.3 million in the same period of 2012. Capital expenditures related to Project Blue Mill used cash of 17.1 million in the first half of 2013.

***Cash Flows from Financing Activities.*** In the six months ended June 30, 2013, financing activities provided cash of 12.5 million, compared to using cash of 12.1 million in the same period of 2012. In the first half of 2013, principal repayments under the Stendal Loan Facility used cash of 20.0 million, compared to 9.6 million in the same period of 2012. During the first half of 2013, borrowing under the loan facility for Project Blue Mill provided cash of 17.0 million. Net borrowing from our revolving credit facilities provided cash of 13.0 million in the first half of 2013, compared to nil in the same period of 2012. In the six months ended June 30, 2013 and 2012, proceeds of government grants provided cash of 4.1 million and 2.3 million, respectively.

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### ***Capital Commitments and Future Liquidity***

Project Blue Mill is designed to increase our Stendal mill's annual energy production by 109,000 MWh and annual pulp production by 30,000 ADMTs. The project remains on schedule and budget and is currently expected to start to generate power sales in or about the end of September 2013. As at June 30, 2013, we had approximately \$6.8 million of capital commitments related to our \$40.0 million Project Blue Mill at the Stendal mill and had \$6.1 million in a separate investment account to manage Project Blue Mill's costs and funding. 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. The investment decree is a condition of our accessing the Project Blue Mill loan facility. As at June 30, 2013, the Stendal mill, based on expenditures to date, had applied for 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.

Other than commitments relating to Project Blue Mill, 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***

Other than with respect to the Second Amended Credit Agreement, there were no material changes outside the ordinary course to any of our material contractual obligations during the first half of 2013.

In July 2013, we renewed the collective agreement for our Rosenthal mill for an additional two year period until May 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 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.

In the six months ended June 30, 2013, accumulated other comprehensive income decreased by \$10.6 million to \$14.6 million, primarily due to the foreign currency translation adjustment.

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Based upon the exchange rate at June 30, 2013, the U.S. dollar has weakened by approximately 3% in value against the Euro since June 30, 2012. See Quantitative and Qualitative Disclosures about Market Risk .

## 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 12 of our Interim Consolidated Financial Statements included herein.

### Summary Financial Highlights for the Restricted Group

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)		(in thousands)	
Pulp revenues	105,541	103,745	205,781	213,634
Energy and chemical revenues	6,040	6,460	13,130	14,451
Operating income (loss)	(5,879)	2,230	(1,979)	7,613
Gain (loss) on derivative instruments	(422)	1,619	(767)	1,619
Income tax provision	(611)	(1,398)	(1,627)	(2,113)
Net loss	(11,172)	(2,568)	(12,964)	(2,885)

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**Selected Production, Sales and Other Data for the Restricted Group**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Restricted Group</b>				
Pulp production ( '000 ADMTs)	192.1	194.1	397.7	412.7
Scheduled production downtime ( '000 ADMTs)	16.0	22.6	16.0	22.6
Scheduled production downtime (days)	11	23	11	23
Pulp sales ( '000 ADMTs)	202.4	196.5	401.8	410.0
Average NBSK pulp list prices in Europe (\$/ADMT) <sup>(1)</sup>	857	837	844	837
Average NBSK pulp list prices in Europe ( /ADMT)	656	652	643	645
Average pulp sales realizations ( /ADMT) <sup>(3)</sup>	521	528	512	520
Energy production ( '000 MWh)	216.3	222.2	446.6	462.4
Energy sales ( '000 MWh)	78.8	85.3	158.7	174.1
Average energy sales realizations ( /MWh)	77	76	83	83
<b>Average Spot Currency Exchange Rates</b>				
/ \$)	0.7655	0.7795	0.7619	0.7710
C\$ / \$( <sup>(3)</sup> )	1.0230	1.0102	1.0160	1.0056
C\$ / ( <sup>(4)</sup> )	1.3374	1.2959	1.3346	1.3044

(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 June 30, 2013 Compared to Three Months Ended June 30, 2012**

Total revenues for the Restricted Group increased by approximately 1% to 111.6 million in the second quarter of 2013, compared to 110.2 million in the second quarter of 2012, primarily due to higher pulp revenues.

Pulp revenues for the Restricted Group for the three months ended June 30, 2013 increased to 105.5 million from 103.7 million in the comparative period of 2012, primarily due to higher pulp sales volumes, partially offset by a weaker U.S. dollar relative to the Euro. The U.S. dollar was approximately 2% weaker versus the Euro in the second quarter of 2013, compared to the second quarter of 2012.

Energy revenues decreased by approximately 8% in the current quarter to 6.0 million from 6.5 million in the same period last year, primarily as a result of lower pulp production at our Celgar mill.

Average list prices for NBSK pulp in Europe were approximately \$857 ( 656) per ADMT in the current quarter, compared to \$837 ( 652) per ADMT in the same quarter last year. In the second quarter of 2013, average pulp sales realizations for the Restricted Group decreased by approximately 1% to 521 per ADMT from 528 per ADMT in the same period last year, primarily due to a weaker U.S. dollar relative to the Euro, partially offset by higher pulp prices.

Pulp production for the Restricted Group decreased by approximately 1% to 192,142 ADMTs in the second quarter of 2013 from 194,093 ADMTs in the same period of 2012, primarily due to decreased pulp production at our Celgar mill. We had 15 days of maintenance downtime at our Celgar mill in the first half of 2013, which, together with a slower startup, resulted in a loss of approximately 30,300 ADMTs of NBSK pulp production. See Results of Operations for further information regarding the Celgar mill shutdown.

Pulp sales volumes of the Restricted Group increased by approximately 3% to 202,446 ADMTs in the second quarter of 2013 from 196,520 ADMTs in the comparative period of 2012, primarily due to higher sales to Europe and China.

Costs and expenses for the Restricted Group in the second quarter of 2013 increased by approximately 9% to 117.5 million from 108.0 million in the comparative period of 2012, primarily due to higher sales volumes, fiber costs and costs associated with the Celgar mill maintenance shutdown.

In the second quarter of 2013, operating depreciation and amortization for the Restricted Group was 8.3 million, compared to 7.8 million in the same quarter last year. Selling, general and administrative expenses for the Restricted Group were 5.6 million, compared to 5.4 million in the same period of 2012.

Transportation costs for the Restricted Group decreased to 12.3 million in the second quarter of 2013 from 12.8 million in the same quarter last year.

Overall, per unit fiber costs of the Restricted Group in the second quarter of 2013 increased by approximately 5%, compared to the same period in 2012. During the second quarter of 2013, fiber costs at our Rosenthal mill were higher than the comparative period in 2012. Increased demand from the European pellet and board producers and sawmills and an under supply of sawlogs kept fiber prices at relatively high levels in the current quarter. Fiber costs at our Celgar mill decreased as a result of increased sawmill activity in the region. Going forward this year, we currently expect fiber costs at our Rosenthal mill to marginally increase and then stabilize, whereas we expect fiber costs at our Celgar mill to decrease moderately.

In the second quarter of 2013, the Restricted Group reported an operating loss of 5.9 million, compared to operating income of 2.2 million in the second quarter of 2012, primarily due to the combined effect of the Celgar mill's maintenance shutdown, higher fiber costs and a weaker U.S. dollar relative to the Euro.

Interest expense for the Restricted Group remained stable at 5.9 million in the second quarter of 2013 and 2012, respectively.

In the second quarter of 2013, the Restricted Group also recorded a loss on derivative instruments of approximately 0.4 million related to two fixed price pulp swap contracts entered into in the fourth quarter of 2012, compared to a derivative gain of 1.6 million in the same quarter of last year.

During the second quarter of 2013, the Restricted Group recorded 0.6 million of income tax expense, compared to income tax expense of 1.4 million in the same period last year.

The Restricted Group reported a net loss for the second quarter of 2013 of 11.2 million, compared to a net loss of 2.6 million in the same period last year, primarily due to the negative impact of the Celgar mill shutdown, higher fiber costs and the weaker U.S. dollar relative to the Euro.

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In the second quarter of 2013, the Restricted Group reported Operating EBITDA of 2.4 million, compared to Operating EBITDA of 10.1 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 June 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 June 30,	
	2013	2012
	(in thousands)	
<b>Restricted Group<sup>(1)</sup></b>		
Net loss	(11,172)	(2,568)
Income tax provision (benefit)	611	1,398
Interest expense	5,880	5,934
Loss (gain) on derivative instruments	422	(1,619)
Other expense (income)	(1,620)	(915)
Operating income (loss)	(5,879)	2,230
Add: Depreciation and amortization	8,324	7,870
Operating EBITDA	2,445	10,100

(1) See Note 12 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results.

***Restricted Group Results Six Months Ended June 30, 2013 Compared to Six Months Ended June 30, 2012***

Total revenues for the Restricted Group decreased by approximately 4% to 218.9 million in the first half of 2013, compared to 228.1 million in the first half of 2012, primarily due to lower pulp and energy revenues at our Celgar mill.

Pulp revenues for the Restricted Group for the six months ended June 30, 2013 decreased to 205.8 million from 213.6 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 1% weaker versus the Euro in the first half of 2013, compared to the same period of 2012.

Energy revenues decreased by approximately 10% in the first half of 2013 to 13.1 million from 14.5 million in the same period last year, primarily as a result of lower pulp production at our Celgar mill.

Average list prices for NBSK pulp in Europe were approximately \$844 ( 643) per ADMT in the first half of 2013, compared to \$837 ( 645) per ADMT in the same period last year. In the first half of 2013, average pulp sales realizations for the Restricted Group decreased by approximately 2% to 512 per ADMT from 520 per ADMT in the same period last year due to the impact of a weaker U.S. dollar compared to the Euro.

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Pulp production for the Restricted Group decreased by approximately 4% to 397,692 ADMTs in the first half of 2013 from 412,713 ADMTs in the same period of 2012, primarily due to decreased pulp production at our Celgar mill. We had 15 days of maintenance downtime at our Celgar mill in the first half of 2013, which, together with a slower startup, resulted in a loss of approximately 30,300 ADMTs of NBSK pulp production.

Pulp sales volumes of the Restricted Group decreased by approximately 2% to 401,771 ADMTs in the first half of 2013 from 409,992 ADMTs in the comparative period of 2012, primarily due to lower sales to the United States.

Costs and expenses for the Restricted Group in the first half of 2013 marginally increased to 220.9 million from 220.5 million in the comparative period of 2012.

In the first half of 2013, operating depreciation and amortization for the Restricted Group was 16.4 million, compared to 15.4 million in the same period last year. Selling, general and administrative expenses for the Restricted Group were 11.4 million, compared to 11.9 million in the same period of 2012.

Transportation costs for the Restricted Group decreased to 23.9 million in the first half of 2013 from 25.6 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 first half of 2013 were flat, compared to the same period in 2012. During the first half of 2013, fiber costs at our Rosenthal mill were higher than the comparative period in 2012. Increased 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 increased sawmill activity in the region. Going forward this year, we currently expect fiber costs at our Rosenthal mill to marginally increase before stabilizing, whereas we expect fiber costs at our Celgar mill to continue to decrease moderately.

In the first half of 2013, the Restricted Group reported an operating loss of 2.0 million, compared to operating income of 7.6 million in the first half of 2012, primarily due to the combined effect of the Celgar mill's maintenance shutdown, lower pulp sales volumes and the weaker U.S. dollar relative to the Euro.

Interest expense for the Restricted Group remained stable at 11.7 million in the first half of 2013 and 2012, respectively.

In the first half of 2013, the Restricted Group also recorded a loss on derivative instruments of approximately 0.8 million related to two fixed price pulp swap contracts entered into in the fourth quarter of 2012, compared to a derivative gain of 1.6 million in the same period of last year.

During the first half of 2013, the Restricted Group recorded 1.6 million of income tax expense, compared to 2.1 million in the same period last year.

The Restricted Group reported a net loss for the first half of 2013 of 13.0 million, compared to a net loss of 2.9 million in the same period last year.

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In the first half of 2013, the Restricted Group reported Operating EBITDA of 14.6 million, compared to Operating EBITDA of 23.2 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 June 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:

	Six Months Ended June 30,	
	2013	2012
	(in thousands)	
<b>Restricted Group<sup>(1)</sup></b>		
Net loss	(12,964)	(2,885)
Income tax provision (benefit)	1,627	2,113
Interest expense	11,746	11,744
Loss (gain) on derivative instruments	767	(1,619)
Other expense (income)	(3,155)	(1,740)
Operating income (loss)	(1,979)	7,613
Add: Depreciation and amortization	16,578	15,573
Operating EBITDA	14,599	23,186

(1) See Note 12 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 at the dates indicated:

	As at June 30, 2013	As at December 31, 2012
	(in thousands)	
<b>Restricted Group Financial Position<sup>(1)</sup></b>		
Cash and cash equivalents	69,467	36,714
Working capital	142,029	132,130
Total assets	643,324	644,119
Long-term liabilities	279,788	260,185
Total equity	312,164	335,353

(1) See Note 12 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results. At June 30, 2013, cash and cash equivalents for the Restricted Group increased to 69.5 million from 36.7 million at the end of 2012.

On July 22, 2013, we completed our registered public offering of \$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.

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### **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, estimates, or words of similar meaning, or future or conditional words 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;

any noncompliance with the financial ratios in our credit facilities and the outcome of negotiations with lenders in respect thereof;

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we may not be able to obtain a waiver of the Ratios or a satisfactory amendment to the Stendal Facilities;

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.

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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. Pulp prices marginally increased during the first half of 2013, and as at June 30, 2013, list prices for NBSK pulp were approximately \$860 per ADMT in Europe, \$950 per ADMT in North America and \$690 per ADMT in China.

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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. 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.

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**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 six months ended June 30, 2013, we recorded an unrealized gain of approximately \$10.9 million on our outstanding interest rate derivative, compared to \$0.6 million in the same period of 2012.

In May 2012, we entered into a fixed price pulp swap contract with a bank. Under the contract, 5,000 metric tonnes, referred to as MTs, of pulp per month is fixed at a price of \$915 per MT for each month between May and December 2012. The contract expired in December 2012.

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

We recorded a loss of approximately \$0.8 million related to these swap contracts in the six months ended June 30, 2013 and a gain of \$1.6 million in the six months ended June 30, 2012.

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

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**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.

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**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 June 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 factors set forth below.

*The agreements governing our indebtedness contain significant restrictions that limit our operating and financial flexibility.*

The indenture governing our Senior Notes and our credit facilities contain covenants that, among other things, limit our ability to:

incur additional indebtedness and issue preferred stock;

pay dividends and make distributions;

repurchase stock or repay subordinated indebtedness;

make certain investments;

transfer, sell or make certain dispositions of assets or engage in sale and leaseback transactions;

incur liens;

enter into transactions with affiliates;

create dividend or other payment restrictions affecting restricted subsidiaries; and

merge, consolidate, amalgamate or sell all or substantially all of our assets to another person.

In addition, our credit facilities require us to maintain specified financial ratios, and we may be unable to meet such ratios. All of these restrictions may limit our ability to execute our business strategy. Moreover, if operating results fall below current levels, we may be unable to comply with these covenants. If that occurs, our lenders could accelerate our indebtedness, in which case we may not be able to repay all of our indebtedness.





*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 intends 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.

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**ITEM 6. EXHIBITS**

<b>Exhibit No.</b>	<b>Description</b>
10.1	Second Amended and Restated Credit Agreement, dated as of May 2, 2013, by and among Zellstoff Celgar Limited partnership, as Borrower, the Lenders from time to time parties thereto, as Lenders, and Canadian Imperial Bank of Commerce, as agent (included as Exhibit 10.1 of the Current Report on Form 8-K filed May 8, 2013 and incorporated by reference herein)
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 June 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.

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**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: August 2, 2013

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