

MERCER INTERNATIONAL INC.

Form 10-Q

August 05, 2010

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**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, 2010**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File No.: 000-51826  
MERCER INTERNATIONAL INC.**

*(Exact name of Registrant as specified in its charter)*

**Washington**  
*(State or other jurisdiction  
of incorporation or organization)*

**47-0956945**  
*(I.R.S. Employer  
Identification No.)*

**Suite 2840, 650 West Georgia Street, Vancouver, British Columbia, Canada, V6B 4N8**

*(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   
(Do not check if a 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 36,551,325 shares of common stock outstanding as at August 4, 2010.

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**MERCER INTERNATIONAL INC.  
INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE SIX MONTHS ENDED JUNE 30, 2010  
(Unaudited)**

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**MERCER INTERNATIONAL INC.**  
**INTERIM CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**  
**(In thousands of Euros)**

|  | <b>June 30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|--|--------------------------|------------------------------|
| <b>ASSETS</b>  |                          |                              |
| Current assets   |                          |                              |
| Cash and cash equivalents                                      | 62,145                   | 51,291                       |
| Receivables  | 125,105                  | 71,143                       |
| Inventories (Note 4)   | 89,582                   | 72,629                       |
| Prepaid expenses and other                                     | 7,448                    | 5,871                        |
| Total current assets   | 284,280                  | 200,934                      |
| Long-term assets   |                          |                              |
| Property, plant and equipment                                  | 872,843                  | 868,558                      |
| Deferred note issuance and other                               | 7,627                    | 8,186                        |
| Deferred income tax  | 3,860                    | 3,426                        |
| Note receivable  | 2,202                    | 2,727                        |
|  | 886,532                  | 882,897                      |
| Total assets   | 1,170,812                | 1,083,831                    |
| <b>LIABILITIES</b>   |                          |                              |
| Current liabilities  |                          |                              |
| Accounts payable and accrued expenses                          | 105,050                  | 85,185                       |
| Pension and other post-retirement benefit obligations (Note 7) | 653                      | 567                          |
| Debt (Note 5)  | 23,189                   | 16,032                       |
| Total current liabilities                                      | 128,892                  | 101,784                      |
| Long-term liabilities  |                          |                              |
| Debt (Note 5)  | 845,992                  | 813,142                      |
| Unrealized interest rate derivative losses (Notes 6 and 9)     | 63,880                   | 52,873                       |
| Pension and other post-retirement benefit obligations (Note 7) | 20,932                   | 17,902                       |
| Capital leases and other                                       | 10,971                   | 12,157                       |
|  | 941,775                  | 896,074                      |
| Total liabilities  | 1,070,667                | 997,858                      |
| <b>EQUITY</b>  |                          |                              |
| Shareholders' equity   |                          |                              |
| Share capital (Note 8)   | 202,973                  | 202,844                      |

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|   |           |           |
|---|-----------|-----------|
| Paid-in capital                               | (5,417)   | (6,082)   |
| Retained earnings (deficit)                   | (92,380)  | (97,235)  |
| Accumulated other comprehensive income (loss) | 26,057    | 23,695    |
| Total shareholders' equity                    | 131,233   | 123,222   |
| Noncontrolling interest (deficit) (Note 10)   | (31,088)  | (37,249)  |
| Total equity                                  | 100,145   | 85,973    |
| Total liabilities and equity                  | 1,170,812 | 1,083,831 |

Commitments and contingencies (Note 11)

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

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**MERCER INTERNATIONAL INC.**  
**INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**  
**(In thousands of Euros, except per share data)**

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| Revenues   |                           |             |                         |             |
| Pulp   | 228,293                   | 147,522     | 399,414                 | 276,555     |
| Energy   | 11,931                    | 11,362      | 21,062                  | 21,901      |
|  | 240,224                   | 158,884     | 420,476                 | 298,456     |
| Costs and expenses   |                           |             |                         |             |
| Operating costs  | 168,275                   | 149,033     | 308,684                 | 281,030     |
| Operating depreciation and amortization                            | 14,106                    | 13,539      | 27,830                  | 26,940      |
|  | 57,843                    | (3,688)     | 83,962                  | (9,514)     |
| Selling, general and administrative expenses                       | 9,955                     | 6,032       | 18,050                  | 13,177      |
| Purchase (sale) of emission allowances                             |                           | 16          |                         | (542)       |
| Operating income (loss)  | 47,888                    | (9,736)     | 65,912                  | (22,149)    |
| Other income (expense)   |                           |             |                         |             |
| Interest expense   | (16,898)                  | (16,319)    | (33,321)                | (32,868)    |
| Investment income (loss)   | 117                       | 138         | 211                     | (3,064)     |
| Foreign exchange gain (loss) on debt                               | (9,371)                   | 5,170       | (14,602)                | 754         |
| Gain (loss) on extinguishment of convertible notes<br>(Note 5)     |                           |             | (929)                   |             |
| Gain (loss) on derivative instruments (Note 6)                     | (4,462)                   | 7,451       | (11,008)                | (7,562)     |
| Total other income (expense)                                       | (30,614)                  | (3,560)     | (59,649)                | (42,740)    |
| Income (loss) before income taxes                                  | 17,274                    | (13,296)    | 6,263                   | (64,889)    |
| Income tax benefit (provision) current                             | (1,319)                   | (65)        | (1,523)                 | (114)       |
| deferred   |                           | 1,888       |                         | 4,919       |
| Net income (loss)  | 15,955                    | (11,473)    | 4,740                   | (60,084)    |
| Less: net loss (income) attributable to<br>noncontrolling interest | (3,554)                   | (3)         | 115                     | 9,258       |
| Net income (loss) attributable to common<br>shareholders           | 12,401                    | (11,476)    | 4,855                   | (50,826)    |

Net income (loss) per share attributable to common  
shareholders (Note 3)

|         |      |        |      |        |
|---------|------|--------|------|--------|
| Basic   | 0.34 | (0.32) | 0.13 | (1.40) |
| Diluted | 0.23 | (0.32) | 0.11 | (1.40) |

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

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**MERCER INTERNATIONAL INC.**  
**INTERIM CONSOLIDATED STATEMENTS OF RETAINED EARNINGS (DEFICIT)**  
**(Unaudited)**  
**(In thousands of Euros)**

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|   | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| Net income (loss) attributable to common shareholders | 12,401                    | (11,476)    | 4,855                   | (50,826)    |
| Retained earnings (deficit), beginning of period      | (104,781)                 | (74,396)    | (97,235)                | (35,046)    |
| Retained earnings (deficit), end of period            | (92,380)                  | (85,872)    | (92,380)                | (85,872)    |

**INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**(Unaudited)**  
**(In thousands of Euros)**

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|   | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| Net income (loss)   | 15,955                    | (11,473)    | 4,740                   | (60,084)    |
| Other comprehensive income (loss)                                   |                           |             |                         |             |
| Foreign currency translation adjustment                             | (4,688)                   | 14,603      | 2,944                   | 9,234       |
| Pension income (expense)  | (234)                     | (22)        | (600)                   | (39)        |
| Unrealized gains (losses) on securities arising during the period   | 12                        | 21          | 18                      | 335         |
| Other comprehensive income (loss)                                   | (4,910)                   | 14,602      | 2,362                   | 9,530       |
| Total comprehensive income (loss)                                   | 11,045                    | 3,129       | 7,102                   | (50,554)    |
| Comprehensive loss (income) attributable to noncontrolling interest | (3,554)                   | (3)         | 115                     | 9,258       |
| Comprehensive income (loss) attributable to common shareholders     | 7,491                     | 3,126       | 7,217                   | (41,296)    |

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



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|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| Cash flows from (used in) operating activities   |                           |             |                         |             |
| Net income (loss) attributable to common shareholders  | 12,401                    | (11,476)    | 4,855                   | (50,826)    |
| Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities |                           |             |                         |             |
| Loss (gain) on derivative instruments  | 4,462                     | (7,451)     | 11,008                  | 7,562       |
| Foreign exchange (gain) loss on debt   | 9,371                     | (5,170)     | 14,602                  | (754)       |
| Loss (gain) on extinguishment of convertible notes   |                           |             | 929                     |             |
| Depreciation and amortization  | 14,176                    | 13,604      | 27,997                  | 27,071      |
| Accretion (income) expense   | 514                       |             | 945                     |             |
| Noncontrolling interest  | 3,554                     | 3           | (115)                   | (9,258)     |
| Deferred income taxes  |                           | (1,888)     |                         | (4,919)     |
| Stock compensation expense   | 227                       | 26          | 733                     | (8)         |
| Pension and other post-retirement expense, net of funding  | 138                       | (7)         | 332                     | (23)        |
| Inventory provisions   |                           |             |                         | 4,587       |
| Other  | 844                       | 925         | 1,847                   | (1,974)     |
| Changes in current assets and liabilities  |                           |             |                         |             |
| Receivables  | (28,798)                  | 4,727       | (45,942)                | 24,708      |
| Inventories  | (5,724)                   | 21,406      | (10,983)                | 27,525      |
| Accounts payable and accrued expenses  | 5,377                     | 15,161      | 13,332                  | 7,940       |
| Other  | 687                       | (366)       | (594)                   | 634         |
| Net cash from (used in) operating activities   | 17,229                    | 29,494      | 18,946                  | 32,265      |
| Cash flows from (used in) investing activities   |                           |             |                         |             |
| Purchase of property, plant and equipment  | (14,542)                  | (7,835)     | (20,392)                | (15,541)    |
| Proceeds on sale of property, plant and equipment  | 162                       | 103         | 549                     | 232         |
| Cash, restricted   |                           |             |                         | 9,469       |
| Notes receivable   | 579                       | 120         | 495                     | 241         |
| Net cash from (used in) investing activities   | (13,801)                  | (7,612)     | (19,348)                | (5,599)     |
| Cash flows from (used in) financing activities   |                           |             |                         |             |
| Repayment of notes payable and debt  |                           |             | (8,250)                 | (13,800)    |
| Repayment of capital lease obligations   | (603)                     | (536)       | (1,607)                 | (1,218)     |
|  | 6,390                     |             | 6,390                   | 10,000      |

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|  |        |        |        |         |
|--|--------|--------|--------|---------|
| Proceeds from borrowings of notes payable and debt           |        |        |        |         |
| Proceeds from government grants                              | 1,144  |        | 10,559 |         |
| Payment of deferred note issuance costs                      |        |        |        | (1,969) |
| Net cash from (used in) financing activities                 | 6,931  | (536)  | 7,092  | (6,987) |
| Effect of exchange rate changes on cash and cash equivalents | 3,094  | (482)  | 4,164  | (31)    |
| Net increase (decrease) in cash and cash equivalents         | 13,453 | 20,864 | 10,854 | 19,648  |
| Cash and cash equivalents, beginning of period               | 48,692 | 41,236 | 51,291 | 42,452  |
| Cash and cash equivalents, end of period                     | 62,145 | 62,100 | 62,145 | 62,100  |

*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)**

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|   | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| <b>Supplemental disclosure of cash flow information</b>                       |                           |             |                         |             |
| Cash paid (received) during the period for                                    |                           |             |                         |             |
| Interest  | 14,604                    | 2,952       | 29,033                  | 31,210      |
| Income taxes  | (37)                      | 43          | 29                      | 72          |
| Supplemental schedule of non-cash investing and financing activities          |                           |             |                         |             |
| Acquisition of production and other equipment under capital lease obligations | 318                       | 80          | 530                     | 116         |
| Decrease in accounts payable relating to investing activities                 | (12,843)                  | (1,602)     | (13,826)                | (1,141)     |

*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, 2009. 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.

Certain prior year amounts in the interim consolidated financial statements have been reclassified to conform to the current year presentation.

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 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 1. The Company and Summary of Significant Accounting Policies (continued)**

*Recently Implemented Accounting Standards*

This section highlights recently implemented accounting standards that had an impact on the Company's financial statements.

In January 2010, the Company adopted Accounting Standards Update (ASU) 2010-06, which amends Accounting Standards Codification 820 (ASC 820), *Fair Value Measurements and Disclosures*. This new accounting guidance requires expanded fair value measurement disclosures in quarterly and annual financial statements. The new guidance clarifies existing disclosure requirements for the Level 2 and 3 fair value measurement. Additionally, the new guidance also requires details of significant transfers of assets between Level 1 and Level 2 fair value measurement categories, including the reasons for such transfers, as well as gross presentation of activity within the Level 3 fair value measurement category. This guidance is effective for the Company on January 1, 2010, except for the gross presentation of Level 3 activity, which is effective January 1, 2011. The adoption of this new accounting guidance did not impact the results of operations or the financial position of the Company.

**Note 2. Stock-Based Compensation**

In June 2010, the Company adopted a new stock incentive plan (the 2010 Plan) which provides for options, restricted stock rights, restricted stock, performance shares, performance share units and stock appreciation rights to be awarded to employees, consultants and non-employee directors. The 2010 Plan replaced the Company's 2004 stock incentive plan (the 2004 Plan). However, the terms of the 2004 Plan will govern prior awards until all awards granted under the 2004 Plan have been exercised, forfeited, cancelled, expired, or otherwise terminated in accordance with the terms thereof. The Company may grant up to a maximum of 2,000,000 common shares plus the number of common shares remaining available for grant pursuant to the 2004 Plan.

*Performance Stock*

Grants of performance stock comprise rights to receive stock at a future date that are contingent on the Company and the grantee achieving certain performance objectives.

During the three and six months ended June 30, 2010, potential stock based performance awards totaled 578,165, which potentially vest on December 31, 2010 (2009 530,623). Expense (income) recognized for the three and six month periods ended June 30, 2010 was 194 and 709, respectively (2009 5 and (55)).

The fair value of performance stock is determined based upon the number of shares awarded and the quoted price of the Company's stock at the reporting date. Performance stock generally cliff vest three years from the award date.

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**MERCER INTERNATIONAL INC.**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(In thousands of Euros, except per share data)**

**Note 2. Stock-Based Compensation (continued)**

On February 11, 2010, the Company awarded a total of 13,000 performance stock to two employees. As of June 30, 2010, no performance stock had vested (2009 nil). During the three and six month period ended June 30, 2010, no performance stock were cancelled (2009 nil and nil).

*Restricted Stock*

The fair value of restricted stock is determined based upon the number of shares granted and the quoted price of the Company's stock on the date of grant. Restricted stock generally vests over one year. Expense is recognized on a straight-line basis over the vesting period. Expense recognized for the three and six month periods ended June 30, 2010 was 22 and 24, respectively (2009 21 and 47).

In the second quarter, 56,000 restricted stock awards were granted to directors of the Company (2009 nil). No restricted stock awards were granted in the first quarter of 2010 or 2009 and there were no restricted stock awards cancelled during the three and six month periods ended June 30, 2010 (2009 nil and nil). As at June 30, 2010, 77,000 restricted stock awards remain unvested.

As at June 30, 2010, the total remaining unrecognized compensation cost related to restricted stock amounted to approximately 226 (2009 nil), which will be amortized over their remaining vesting periods.

*Stock Options*

During the three and six month periods ended June 30, 2010 and 2009, no options were exercised, cancelled or granted and 738,334 options expired during the first quarter of 2010 (2009 nil).

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|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|   | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| Net income (loss) attributable to common shareholders basic     | 12,401                    | (11,476)    | 4,855                   | (50,826)    |
| Interest on convertible notes, net of tax                       | 747                       |             | 1,437                   |             |
| Net income (loss) attributable to common shareholders diluted   | 13,148                    | (11,476)    | 6,292                   | (50,826)    |
| Net income (loss) per share attributable to common shareholders |                           |             |                         |             |
| Basic   | 0.34                      | (0.32)      | 0.13                    | (1.40)      |
| Diluted   | 0.23                      | (0.32)      | 0.11                    | (1.40)      |
| Weighted average number of common shares outstanding            |                           |             |                         |             |
| Basic <sup>(1)</sup>  | 36,349,340                | 36,289,181  | 36,334,846              | 36,287,115  |
| Effect of dilutive instruments                                  |                           |             |                         |             |
| Performance rights  | 425,668                   |             | 429,865                 |             |
| Restricted stock  | 22,067                    |             | 16,498                  |             |
| Stock options and awards  |                           |             |                         |             |
| Convertible notes   | 20,197,563                |             | 20,212,058              |             |
| Diluted   | 56,994,638                | 36,289,181  | 56,993,267              | 36,287,115  |

(1) The basic weighted average number of shares excludes performance and restricted stock which have been issued, but have not vested as at June 30, 2010 and 2009.

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 earnings per share.

Stock options and awards excluded from the calculation of diluted income (loss) per share attributable to common shareholders because they are anti-dilutive represented 190,000 shares for the three and six month periods ended June 30, 2010 (2009 928,334).

Shares associated with the convertible notes excluded from the calculation of diluted income (loss) per share attributable to common shareholders because they are anti-dilutive represented 8,678,065 shares for the three and six month periods ended June 30, 2009.

Performance stock excluded from the calculation of diluted income (loss) per share attributable to common shareholders because they are anti-dilutive represented 369,924 shares for the three and six month periods ended June 30, 2009.

**Note 4. Inventories**

|                           | <b>June 30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|---------------------------|--------------------------|------------------------------|
| Raw materials             | 39,255                   | 24,888                       |
| Finished goods            | 24,081                   | 24,198                       |
| Work in process and other | 26,246                   | 23,543                       |
|                           | 89,582                   | 72,629                       |

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Debt consists of the following:

|   | <b>June 30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|---|--------------------------|------------------------------|
| Note payable to bank, included in a total loan credit facility of 827,950 to finance the construction related to the Stendal mill (a) | 506,323                  | 514,574                      |
| Senior notes due February 2013, interest at 9.25% accrued and payable semi-annually, unsecured (b)                                    | 252,238                  | 216,299                      |
| Subordinated convertible notes due October 2010, interest at 8.5% accrued and payable semi-annually (c)                               | 1,851                    | 16,749                       |
| Subordinated convertible notes due January 2012, interest at 8.5% accrued and payable semi-annually (d)                               | 50,151                   | 26,160                       |
| Credit agreement with a lender with respect to a revolving credit facility of C\$40 million (e)                                       | 23,782                   | 16,000                       |
| Loan payable to the noncontrolling shareholder of the Stendal mill (f)  | 30,485                   | 35,881                       |
| Credit agreement with a bank with respect to a revolving credit facility of 25,000 (g)  |                          |                              |
| Investment loan agreement with a lender with respect to the wash press project at the Rosenthal mill of 4,351 (h)                     | 4,351                    | 3,511                        |
| Credit agreement with a bank with respect to a revolving credit facility of 3,500 (i)   |                          |                              |
|   | 869,181                  | 829,174                      |
| Less: current portion   | (23,189)                 | (16,032)                     |
| Debt, less current portion  | 845,992                  | 813,142                      |

The Company made scheduled principal repayments under these facilities of 8,250 during the six months ended June 30, 2010 (2009 13,800). As of June 30, 2010, the principal maturities of debt are as follows:

| <b>Matures</b>      | <b>Amount</b> |
|---------------------|---------------|
| 2010                | 8,062         |
| 2011                | 24,255        |
| 2012                | 75,822        |
| 2013 <sup>(1)</sup> | 317,108       |
| 2014                | 40,543        |
| Thereafter          | 403,391       |
|                     | 869,181       |

(1)

Includes  
revolving credit  
facility principal  
amounts  
totalling 23,782.

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**(In thousands of Euros, except per share data)**

**Note 5. Debt (continued)**

Certain of the Company's debt agreements 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 other important qualifications and exceptions. As at June 30, 2010, the Company was in compliance with the terms of the indenture.

- (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 1.50% (rates on amounts of borrowing at June 30, 2010 range from 1.85% to 2.44%), principal due in required installments beginning September 30, 2006 until September 30, 2017, collateralized by the 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 468,823 of outstanding principal, subject to a debt service reserve account required to pay amounts due in the following twelve months under the terms of the Stendal Loan Facility; payment of dividends is only permitted if certain cash flow requirements are met.

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, including approximately 20,000, 26,000, 21,000 of scheduled principal payments that were originally due in 2009, 2010, and 2011, respectively. 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, held by Stendal which will be used first to fund the debt service reserve account to a level sufficient to service the amounts due and payable under the Stendal Loan Facility during the then following 12 months, or Fully Funded , and second to prepay the deferred principal amounts.

- (b) In February 2005, the Company issued \$310 million of senior notes due February 2013, which bear interest at 9.25% accrued and payable semi-annually, and are unsecured. The Company may redeem all or a part of the notes at redemption prices (expressed as a percentage of principal amount) equal to 102.31% for the twelve month period beginning on February 15, 2010, and 100.00% beginning on February 15, 2011 and at any time thereafter, plus accrued and unpaid interest.

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**Note 5. Debt (continued)**

- (c) As at June 30, 2010, the Subordinated Convertible Notes due October 2010 had approximately \$2.3 million of principal outstanding. The Subordinated Convertible Notes due October 2010, bear interest at 8.5% accrued and payable semi-annually, are convertible at any time by the holder into common shares of the Company at \$7.75 per share and are unsecured. The Company may redeem for cash all or a portion of these notes at any time at 100% of the principal amount of the notes plus accrued and unpaid interest up to the redemption date. See Note 5(d).
- (d) On December 10, 2009, the Company exchanged approximately \$43.3 million of Subordinated Convertible Notes due October 2010 through private exchange agreements with the holders thereof for approximately \$43.8 million of Subordinated Convertible Notes due January 2012. On January 22, 2010, through an exchange offer, the Company exchanged a further \$21.7 million of Subordinated Convertible Notes due October 2010 for approximately \$22.0 million of the Company's Subordinated Convertible Notes due January 2012. The Company recognized both exchange transactions of the Subordinated Convertible Notes as extinguishments of debt in accordance with ASC Topic 470, *Debt*, because the fair value of the embedded conversion option changed by more than 10% in both transactions. As a result, for the year ended December 31, 2009, the Company accounted for the December 10, 2009 exchange as a debt extinguishment and recognized a gain of 4,447 in the Consolidated Statement of Operations. For the six months ended June 30, 2010, the Company recognized a loss of 929 as a result of the January 22, 2010 exchange. The gain and loss, which were determined using fair market values prevailing at the time of the transactions, will both be accreted to income through to January 2012 through interest expense yielding an effective interest rate of approximately 13% on the December 10, 2009 exchange and 3% on the January 22, 2010 exchange.

The Subordinated Convertible Notes due January 2012 bear interest at 8.5%, accrued and payable semi-annually, are convertible at anytime by the holder into common shares of the Company at \$3.30 per share and are unsecured. The Company may redeem for cash all or a portion of the notes on or after July 15, 2011 at 100% of the principal amount of the notes plus accrued interest up to the redemption date. During the six months ended June 30, 2010, \$169,027 of Subordinated Convertible Notes due January 2012 were converted into 51,218 shares.

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**Note 5. Debt (continued)**

- (e) Credit agreement with respect to a revolving credit facility of C\$40.0 million for the Celgar mill. The credit agreement matures May 2013. Borrowings under the credit agreement 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 3.75% or Canadian prime plus 2.00%. U.S. dollar denominated amounts bear interest at LIBOR plus 3.75% or U.S. base plus 2.00%. As at June 30, 2010, this facility was accruing interest at a rate of approximately 4.42% and the undrawn amount was approximately C\$8.0 million.
- (f) Loans payable to the noncontrolling shareholder of the Stendal mill bear interest at 7%, which is accrued semi-annually. The loan payable is unsecured, subordinated to all liabilities of the Stendal mill, and is due in 2017. The balance includes principal and accrued interest. See Note 10 Noncontrolling Interest.
- (g) A 25,000 working capital facility at the Rosenthal mill that matures in December 2012. Borrowings under the facility are collateralized by the mill's inventory and receivables and bear interest at approximately Euribor plus 3.50%. As at June 30, 2010, approximately 2,100 of this facility was supporting bank guarantees leaving approximately 22,900 undrawn.
- (h) On August 19, 2009 the Company finalized an investment loan agreement with a lender relating to the new wash press at the Rosenthal mill. The four-year amortizing investment loan was completed with a total facility of 4,351 bearing interest at the rate of Euribor plus 2.75%. Borrowings under this agreement are secured by the new wash press equipment. As at June 30, 2010, this facility was drawn by 4,351 and was accruing interest at a rate of 3.20%.
- (i) On February 8, 2010 the Rosenthal mill finalized a credit agreement with a lender for a 3,500 facility maturing in December 2012. Borrowings under the facility will bear interest at the rate of the 3-month Euribor plus 3.5% and are secured by certain land at our Rosenthal mill. As at June 30, 2010, this facility was undrawn.

**Note 6. 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. Currently, the primary risk managed using derivative instruments is interest rate risk.

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**Note 6. Derivative Transactions (continued)**

During 2004, the Company entered into certain variable-to-fixed interest rate swaps in connection with the Stendal Loan Facility with respect to an aggregate maximum principal amount of approximately 612,600 of the total indebtedness under the Stendal Loan Facility. Under the interest rate swaps, the Company pays a fixed rate and receives a floating rate with the interest payments being calculated on a notional amount. Currently, the contracts have an aggregate notional amount of 467,926 at a fixed interest rate of 5.28% and they mature October 2017 (generally matching the maturity of the Stendal Loan Facility). The Company substantially converted the Stendal Loan Facility from a variable interest rate loan into a fixed interest rate loan, thereby reducing interest rate uncertainty.

The Company recognized an unrealized loss of 4,462 and 11,008, respectively, with respect to these interest rate swaps for the three and six months ended June 30, 2010 (2009 gain of 7,451 and loss of 7,562), in the Gain (loss) on derivative instruments line in the Interim Consolidated Statement of Operations and Interim Consolidated Statement of Cash Flows. Derivative instruments are required to be measured at their fair value. Accordingly, the fair value of the interest rate swap is presented in Unrealized interest rate derivative losses within the long-term liabilities section in the Interim Consolidated Balance Sheets, which currently amounts to a cumulative unrealized loss of 63,880 (2009 52,873).

The interest rate derivative contracts are with the same banks that hold the Stendal Loan Facility and the Company does not anticipate non-performance by the banks.

**Note 7. 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 German mills. The largest component of this obligation is with respect to the Celgar mill which maintains defined benefit pension 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 for the three and six month periods ended June 30, 2010 totaled 247 and 399, respectively (2009 235 and 583).

The Company anticipates based on actuarial estimates that it will make contributions to the defined benefit pension plan of approximately 319 in 2010.

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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.

|                                | <b>Three Months Ended June 30,</b> |                                 | <b>2009</b>             |                                 |
|--------------------------------|------------------------------------|---------------------------------|-------------------------|---------------------------------|
|                                | <b>2010</b>                        | <b>Post-Retirement Benefits</b> | <b>Pension Benefits</b> | <b>Post-Retirement Benefits</b> |
| Service cost                   | 21                                 | 102                             | 14                      | 84                              |
| Interest cost                  | 437                                | 202                             | 377                     | 203                             |
| Expected return on plan assets | (409)                              |                                 | (317)                   |                                 |
| Recognized net loss (gain)     | 115                                | (81)                            | 35                      | (59)                            |
| Net periodic benefit cost      | 164                                | 223                             | 109                     | 228                             |

|                                | <b>Six Months Ended June 30,</b> |                                 | <b>2009</b>             |                                 |
|--------------------------------|----------------------------------|---------------------------------|-------------------------|---------------------------------|
|                                | <b>2010</b>                      | <b>Post-Retirement Benefits</b> | <b>Pension Benefits</b> | <b>Post-Retirement Benefits</b> |
| Service cost                   | 40                               | 195                             | 28                      | 167                             |
| Interest cost                  | 832                              | 384                             | 747                     | 401                             |
| Expected return on plan assets | (778)                            |                                 | (628)                   |                                 |
| Recognized net loss (gain)     | 218                              | (154)                           | 69                      | (116)                           |
| Net periodic benefit cost      | 312                              | 425                             | 216                     | 452                             |

**Note 8. Share Capital***Common shares*

The Company has authorized 200,000,000 common shares (2009 200,000,000) with a par value of \$1 per share. During the six months ended June 30, 2010, 51,218 shares were issued as a result of certain holders of the Company's Subordinated Convertible Notes due January 2012 exercising their conversion option. See Note 5(d) Debt. As at June 30, 2010 and December 31, 2009, the Company had 36,551,325 and 36,443,487 common shares issued and outstanding, respectively.

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The Company has authorized 50,000,000 preferred shares (2009 50,000,000) 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, 2010, no preferred shares had been issued by the Company.

**Note 9. Financial Instruments**

The fair value of financial instruments at June 30, 2010 and December 31, 2009 is summarized as follows:

|  | <b>June 30, 2010</b>       |                       | <b>December 31, 2009</b>   |                       |
|--|----------------------------|-----------------------|----------------------------|-----------------------|
|  | <b>Carrying<br/>Amount</b> | <b>Fair<br/>Value</b> | <b>Carrying<br/>Amount</b> | <b>Fair<br/>Value</b> |
| Cash and cash equivalents                    | 62,145                     | 62,145                | 51,291                     | 51,291                |
| Investments                                  | 155                        | 155                   | 135                        | 135                   |
| Receivables                                  | 125,105                    | 125,105               | 71,143                     | 71,143                |
| Notes receivable                             | 3,897                      | 3,897                 | 3,819                      | 3,819                 |
| Accounts payable and accrued expenses        | 105,050                    | 105,050               | 85,185                     | 85,185                |
| Debt   | 869,181                    | 865,684               | 829,174                    | 769,207               |
| Interest rate derivative contracts liability | 63,880                     | 63,880                | 52,873                     | 52,873                |

The carrying value of cash and cash equivalents and accounts payable and accrued expenses 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. The fair value of notes receivable was estimated using discounted cash flows at prevailing market rates. The fair value of debt reflects recent market transactions and discounted cash flow estimates. The fair value of the interest rate derivatives is based on observable inputs including applicable yield curves.

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**Note 9. Financial Instruments (continued)**

The fair value methodologies and, as a result, the fair value of the Company's investments and derivative instruments are determined based on the fair value hierarchy provided in ASC 820. The fair value hierarchy per ASC 820 is 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 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 investments within Level 1 of the valuation hierarchy where quoted prices are available in an active market. Level 1 investments include exchange-traded equities.

The Company's derivatives are classified within Level 2 of the valuation hierarchy, as they are traded on the over-the-counter market and are valued using internal models that use as their basis readily observable market inputs, such as forward interest rates.

The valuation techniques used by the Company are based upon observable inputs. 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, in determining the fair value of the derivative instruments. The counterparty to our interest rate swap derivative is a multi-national financial institution.

The following table presents a summary of the Company's outstanding financial instruments and their estimated fair values under the hierarchy defined in ASC 820:

**Fair value measurements at June 30, 2010 using:**

| Description                         | Quoted<br>prices in<br>active<br>markets<br>for<br>identical<br>assets<br>(Level 1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) | Total  |
|-------------------------------------|---|---|--|--------|
| <b>Assets</b>                       |   |   |  |        |
| Investments (a)                     | 155   |   |  | 155    |
| <b>Liabilities</b>                  |   |   |  |        |
| Derivatives (b) Interest rate swaps |   | 63,880  |  | 63,880 |

(a) Based on observable market data.

(b) Based on observable

inputs for the  
liability (yield  
curves  
observable at  
specific  
intervals).

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**Note 10. Noncontrolling Interest**

During the first quarter of 2010, the noncontrolling interest holder agreed to convert certain interest claims totaling 6,275 borne from shareholder loans into a capital contribution. As a result of this conversion, the Company reduced the amount owing to the noncontrolling shareholder and decreased the noncontrolling shareholder's share of losses.

**Note 11. Commitments and Contingencies**

As part of the Company's Green Energy project (the Green Energy Project) for the Celgar mill, during 2009 and 2010 the Company entered into a number of contracts for the purchase of a new 48 megawatt condensing turbine-generator set, as well as other related equipment commitments. As at June 30, 2010, the value of the project remaining to be completed is approximately 9,700 (C\$12.6 million), a majority of which is due to be paid within the next year and is being funded by the Canadian Federal Government's Pulp and Paper Green Transformation Program (the Program). Pursuant to a contribution agreement finalized in November 2009, the Program will provide approximately C\$40.0 million to complete the Green Energy Project. The Company is also eligible for an additional C\$17.7 million under the Program for future qualifying projects.

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. While the outcome of these 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.

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**Note 12. Restricted Group Supplemental Disclosure**

The terms of the indenture governing our 9.25% senior unsecured 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, 2010 and 2009, 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 Sheet**

|   | <b>June 30, 2010</b>        |                                      |                     |                               |
|---|-----------------------------|--------------------------------------|---------------------|-------------------------------|
|   | <b>Restricted<br/>Group</b> | <b>Unrestricted<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated<br/>Group</b> |
| <b>ASSETS</b>   |                             |                                      |                     |                               |
| Current assets  |                             |                                      |                     |                               |
| Cash and cash equivalents                             | 39,485                      | 22,660                               |                     | 62,145                        |
| Receivables   | 69,176                      | 55,929                               |                     | 125,105                       |
| Inventories   | 58,250                      | 31,332                               |                     | 89,582                        |
| Prepaid expenses and other                            | 4,752                       | 2,696                                |                     | 7,448                         |
| <b>Total current assets</b>                           | <b>171,663</b>              | <b>112,617</b>                       |                     | <b>284,280</b>                |
| Property, plant and equipment                         | 378,462                     | 494,381                              |                     | 872,843                       |
| Deferred note issuance and other                      | 3,139                       | 4,488                                |                     | 7,627                         |
| Deferred income tax                                   | 3,860                       |                                      |                     | 3,860                         |
| Due from unrestricted group                           | 76,008                      |                                      | (76,008)            |                               |
| Note receivable                                       | 2,202                       |                                      |                     | 2,202                         |
| <b>Total assets</b>                                   | <b>635,334</b>              | <b>611,486</b>                       | <b>(76,008)</b>     | <b>1,170,812</b>              |
| <b>LIABILITIES</b>                                    |                             |                                      |                     |                               |
| Current liabilities                                   |                             |                                      |                     |                               |
| Accounts payable and accrued expenses                 | 65,421                      | 39,629                               |                     | 105,050                       |
| Pension and other post-retirement benefit obligations | 653                         |                                      |                     | 653                           |
| Debt  | 2,939                       | 20,250                               |                     | 23,189                        |
| <b>Total current liabilities</b>                      | <b>69,013</b>               | <b>59,879</b>                        |                     | <b>128,892</b>                |
| Debt  | 329,434                     | 516,558                              |                     | 845,992                       |
| Due to restricted group                               |                             | 76,008                               | (76,008)            |                               |
| Unrealized interest rate derivative losses            |                             | 63,880                               |                     | 63,880                        |
| Pension and other post-retirement benefit obligations | 20,932                      |                                      |                     | 20,932                        |
| Capital leases and other                              | 6,806                       | 4,165                                |                     | 10,971                        |

|                                      |         |          |          |           |
|--------------------------------------|---------|----------|----------|-----------|
| Total liabilities                    | 426,185 | 720,490  | (76,008) | 1,070,667 |
| <b>EQUITY</b>                        |         |          |          |           |
| Total shareholders' equity (deficit) | 209,149 | (77,916) |          | 131,233   |
| Noncontrolling interest (deficit)    |         | (31,088) |          | (31,088)  |
| Total liabilities and equity         | 635,334 | 611,486  | (76,008) | 1,170,812 |

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**Note 12. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Balance Sheet**

|   | <b>December 31, 2009</b>    |                                      |                     |                               |
|---|-----------------------------|--------------------------------------|---------------------|-------------------------------|
|   | <b>Restricted<br/>Group</b> | <b>Unrestricted<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated<br/>Group</b> |
| <b>ASSETS</b>   |                             |                                      |                     |                               |
| Current assets  |                             |                                      |                     |                               |
| Cash and cash equivalents                             | 20,635                      | 30,656                               |                     | 51,291                        |
| Receivables   | 34,588                      | 36,555                               |                     | 71,143                        |
| Inventories   | 52,897                      | 19,732                               |                     | 72,629                        |
| Prepaid expenses and other                            | 3,452                       | 2,419                                |                     | 5,871                         |
| Total current assets                                  | 111,572                     | 89,362                               |                     | 200,934                       |
| Property, plant and equipment                         | 362,311                     | 506,247                              |                     | 868,558                       |
| Deferred note issuance and other                      | 3,388                       | 4,798                                |                     | 8,186                         |
| Deferred income tax                                   | 3,426                       |                                      |                     | 3,426                         |
| Due from unrestricted group                           | 72,553                      |                                      | (72,553)            |                               |
| Note receivable                                       | 2,727                       |                                      |                     | 2,727                         |
| Total assets  | 555,977                     | 600,407                              | (72,553)            | 1,083,831                     |
| <b>LIABILITIES</b>                                    |                             |                                      |                     |                               |
| Current liabilities                                   |                             |                                      |                     |                               |
| Accounts payable and accrued expenses                 | 51,875                      | 33,310                               |                     | 85,185                        |
| Pension and other post-retirement benefit obligations | 567                         |                                      |                     | 567                           |
| Debt  | 2,115                       | 13,917                               |                     | 16,032                        |
| Total current liabilities                             | 54,557                      | 47,227                               |                     | 101,784                       |
| Debt  | 276,604                     | 536,538                              |                     | 813,142                       |
| Due to restricted group                               |                             | 72,553                               | (72,553)            |                               |
| Unrealized interest rate derivative losses            |                             | 52,873                               |                     | 52,873                        |
| Pension and other post-retirement benefit obligations | 17,902                      |                                      |                     | 17,902                        |
| Capital leases and other                              | 6,667                       | 5,490                                |                     | 12,157                        |
| Total liabilities                                     | 355,730                     | 714,681                              | (72,553)            | 997,858                       |
| <b>EQUITY</b>   |                             |                                      |                     |                               |
| Total shareholders' equity (deficit)                  | 200,247                     | (77,025)                             |                     | 123,222                       |

|                                   |         |          |          |           |
|-----------------------------------|---------|----------|----------|-----------|
| Noncontrolling interest (deficit) |         | (37,249) |          | (37,249)  |
| Total liabilities and equity      | 555,977 | 600,407  | (72,553) | 1,083,831 |

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**Note 12. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Statements of Operations**

|   | <b>Three Months Ended June 30, 2010</b> |                                      |                     | <b>Consolidated<br/>Group</b> |
|---|---|--------------------------------------|---------------------|-------------------------------|
|   | <b>Restricted<br/>Group</b>             | <b>Unrestricted<br/>Subsidiaries</b> | <b>Eliminations</b> |                               |
| Revenues  |   |                                      |                     |                               |
| Pulp  | 124,840                                 | 103,453                              |                     | 228,293                       |
| Energy  | 3,840                                   | 8,091                                |                     | 11,931                        |
|   | 128,680                                 | 111,544                              |                     | 240,224                       |
| Operating costs   | 95,870                                  | 72,405                               |                     | 168,275                       |
| Operating depreciation and amortization                         | 7,628                                   | 6,478                                |                     | 14,106                        |
| Selling, general and administrative expenses and other          | 6,730                                   | 3,225                                |                     | 9,955                         |
|   | 110,228                                 | 82,108                               |                     | 192,336                       |
| Operating income (loss)   | 18,452                                  | 29,436                               |                     | 47,888                        |
| Other income (expense)  |   |                                      |                     |                               |
| Interest expense  | (7,957)                                 | (10,116)                             | 1,175               | (16,898)                      |
| Investment income (loss)  | 1,285                                   | 7                                    | (1,175)             | 117                           |
| Foreign exchange gain (loss) on debt                            | (9,371)                                 |                                      |                     | (9,371)                       |
| Gain (loss) on derivative instruments                           |   | (4,462)                              |                     | (4,462)                       |
| Total other income (expense)                                    | (16,043)                                | (14,571)                             |                     | (30,614)                      |
| Income (loss) before income taxes                               | 2,409                                   | 14,865                               |                     | 17,274                        |
| Income tax benefit (provision)                                  | (334)                                   | (985)                                |                     | (1,319)                       |
| Net income (loss)   | 2,075                                   | 13,880                               |                     | 15,955                        |
| Less: net (income) loss attributable to noncontrolling interest |   | (3,554)                              |                     | (3,554)                       |
| Net income (loss) attributable to common shareholders           | 2,075                                   | 10,326                               |                     | 12,401                        |

|  | <b>Three Months Ended June 30, 2009</b> |                                      |                     | <b>Consolidated<br/>Group</b> |
|--|---|--------------------------------------|---------------------|-------------------------------|
|  | <b>Restricted<br/>Group</b>             | <b>Unrestricted<br/>Subsidiaries</b> | <b>Eliminations</b> |                               |

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|   |          |          |         |          |
|---|----------|----------|---------|----------|
| Revenues  |          |          |         |          |
| Pulp  | 76,443   | 71,079   |         | 147,522  |
| Energy  | 3,945    | 7,417    |         | 11,362   |
|   | 80,388   | 78,496   |         | 158,884  |
| Operating costs   | 79,793   | 69,240   |         | 149,033  |
| Operating depreciation and amortization                         | 6,888    | 6,651    |         | 13,539   |
| Selling, general and administrative expenses and other          | 3,314    | 2,734    |         | 6,048    |
|   | 89,995   | 78,625   |         | 168,620  |
| Operating income (loss)   | (9,607)  | (129)    |         | (9,736)  |
| Other income (expense)  |          |          |         |          |
| Interest expense  | (6,927)  | (10,513) | 1,121   | (16,319) |
| Investment income (loss)  | 1,234    | 25       | (1,121) | 138      |
| Foreign exchange gain (loss) on debt                            | 5,170    |          |         | 5,170    |
| Gain (loss) on derivative instruments                           |          | 7,451    |         | 7,451    |
| Total other income (expense)                                    | (523)    | (3,037)  |         | (3,560)  |
| Income (loss) before income taxes                               | (10,130) | (3,166)  |         | (13,296) |
| Income tax benefit (provision)                                  | (1,149)  | 2,972    |         | 1,823    |
| Net income (loss)   | (11,279) | (194)    |         | (11,473) |
| Less: net (income) loss attributable to noncontrolling interest |          | (3)      |         | (3)      |
| Net income (loss) attributable to common shareholders           | (11,279) | (197)    |         | (11,476) |

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**MERCER INTERNATIONAL INC.**  
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**(Unaudited)**

**(In thousands of Euros, except per share data)**

**Note 12. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Statements of Operations**

|   | <b>Six Months Ended June 30, 2010</b> |                                      |                     |                               |
|---|---------------------------------------|--------------------------------------|---------------------|-------------------------------|
|   | <b>Restricted<br/>Group</b>           | <b>Unrestricted<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated<br/>Group</b> |
| Revenues  |                                       |                                      |                     |                               |
| Pulp  | 231,257                               | 168,157                              |                     | 399,414                       |
| Energy  | 7,215                                 | 13,847                               |                     | 21,062                        |
|   | 238,472                               | 182,004                              |                     | 420,476                       |
| Operating costs   | 177,535                               | 131,149                              |                     | 308,684                       |
| Operating depreciation and amortization                         | 14,841                                | 12,989                               |                     | 27,830                        |
| Selling, general and administrative expenses and other          | 11,571                                | 6,479                                |                     | 18,050                        |
|   | 203,947                               | 150,617                              |                     | 354,564                       |
| Operating income (loss)   | 34,525                                | 31,387                               |                     | 65,912                        |
| Other income (expense)  |                                       |                                      |                     |                               |
| Interest expense  | (15,277)                              | (20,380)                             | 2,336               | (33,321)                      |
| Investment income (loss)  | 2,524                                 | 23                                   | (2,336)             | 211                           |
| Foreign exchange gain (loss) on debt                            | (14,602)                              |                                      |                     | (14,602)                      |
| Gain (loss) on extinguishment of convertible notes              | (929)                                 |                                      |                     | (929)                         |
| Gain (loss) on derivative instruments                           |                                       | (11,008)                             |                     | (11,008)                      |
| Total other income (expense)                                    | (28,284)                              | (31,365)                             |                     | (59,649)                      |
| Income (loss) before income taxes                               | 6,241                                 | 22                                   |                     | 6,263                         |
| Income tax benefit (provision)                                  | (495)                                 | (1,028)                              |                     | (1,523)                       |
| Net income (loss)   | 5,746                                 | (1,006)                              |                     | 4,740                         |
| Less: net (income) loss attributable to noncontrolling interest |                                       | 115                                  |                     | 115                           |
| Net income (loss) attributable to common shareholders           | 5,746                                 | (891)                                |                     | 4,855                         |

|   | <b>Six Months Ended June 30, 2009</b> |                                      |                     |                               |
|---|---------------------------------------|--------------------------------------|---------------------|-------------------------------|
|   | <b>Restricted<br/>Group</b>           | <b>Unrestricted<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated<br/>Group</b> |
| Revenues  |                                       |                                      |                     |                               |
| Pulp  | 151,459                               | 125,096                              |                     | 276,555                       |
| Energy  | 7,961                                 | 13,940                               |                     | 21,901                        |
|   | 159,420                               | 139,036                              |                     | 298,456                       |
| Operating costs   | 154,228                               | 126,802                              |                     | 281,030                       |
| Operating depreciation and amortization                         | 13,592                                | 13,348                               |                     | 26,940                        |
| Selling, general and administrative expenses and other          | 6,617                                 | 6,018                                |                     | 12,635                        |
|   | 174,437                               | 146,168                              |                     | 320,605                       |
| Operating income (loss)   | (15,017)                              | (7,132)                              |                     | (22,149)                      |
| Other income (expense)  |                                       |                                      |                     |                               |
| Interest expense  | (14,229)                              | (20,869)                             | 2,230               | (32,868)                      |
| Investment income (loss)  | 2,150                                 | (2,984)                              | (2,230)             | (3,064)                       |
| Foreign exchange gain (loss) on debt                            | 754                                   |                                      |                     | 754                           |
| Gain (loss) on derivative instruments                           |                                       | (7,562)                              |                     | (7,562)                       |
| Total other income (expense)                                    | (11,325)                              | (31,415)                             |                     | (42,740)                      |
| Income (loss) before income taxes                               | (26,342)                              | (38,547)                             |                     | (64,889)                      |
| Income tax benefit (provision)                                  | (941)                                 | 5,746                                |                     | 4,805                         |
| Net income (loss)   | (27,283)                              | (32,801)                             |                     | (60,084)                      |
| Less: net (income) loss attributable to noncontrolling interest |                                       | 9,258                                |                     | 9,258                         |
| Net income (loss) attributable to common shareholders           | (27,283)                              | (23,543)                             |                     | (50,826)                      |

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**MERCER INTERNATIONAL INC.**  
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**(Unaudited)**

**(In thousands of Euros, except per share data)**

**Note 12. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Statement of Cash Flows**

|  | <b>Three Months Ended June 30, 2010</b> |                               |                               |
|--|---|-------------------------------|-------------------------------|
|  | <b>Restricted<br/>Group</b>             | <b>Unrestricted<br/>Group</b> | <b>Consolidated<br/>Group</b> |
| Cash flows from (used in) operating activities   |   |                               |                               |
| Net income (loss) attributable to common shareholders  | 2,075                                   | 10,326                        | 12,401                        |
| Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities |   |                               |                               |
| Loss (gain) on derivative instruments  |   | 4,462                         | 4,462                         |
| Foreign exchange loss (gain) on debt   | 9,371                                   |                               | 9,371                         |
| Depreciation and amortization  | 7,698                                   | 6,478                         | 14,176                        |
| Accretion (income) expense   | 514                                     |                               | 514                           |
| Noncontrolling interest  |   | 3,554                         | 3,554                         |
| Stock compensation expense   | 227                                     |                               | 227                           |
| Pension and other post-retirement expense, net of funding  | 138                                     |                               | 138                           |
| Other  | 182                                     | 662                           | 844                           |
| Changes in current assets and liabilities  |   |                               |                               |
| Receivables  | (10,186)                                | (18,612)                      | (28,798)                      |
| Inventories  | 810                                     | (6,534)                       | (5,724)                       |
| Accounts payable and accrued expenses  | 10,567                                  | (5,190)                       | 5,377                         |
| Other <sup>(1)</sup>   | (4,860)                                 | 5,547                         | 687                           |
| Net cash from (used in) operating activities   | 16,536                                  | 693                           | 17,229                        |
| Cash flows from (used in) investing activities   |   |                               |                               |
| Purchase of property, plant and equipment  | (14,148)                                | (394)                         | (14,542)                      |
| Proceeds on sale of property, plant and equipment  | 9                                       | 153                           | 162                           |
| Note receivable  | 579                                     |                               | 579                           |
| Net cash from (used in) investing activities   | (13,560)                                | (241)                         | (13,801)                      |
| Cash flows from (used in) financing activities   |   |                               |                               |
| Repayment of capital lease obligations   | (202)                                   | (401)                         | (603)                         |
| Proceeds from borrowings of notes payable and debt   | 6,390                                   |                               | 6,390                         |
| Proceeds from government grants  | 1,144                                   |                               | 1,144                         |
| Net cash from (used in) financing activities   | 7,332                                   | (401)                         | 6,931                         |
| Effect of exchange rate changes on cash and cash equivalents   | 3,094                                   |                               | 3,094                         |

|  |        |        |        |
|--|--------|--------|--------|
| Net increase (decrease) in cash and cash equivalents | 13,402 | 51     | 13,453 |
| Cash and cash equivalents, beginning of period       | 26,083 | 22,609 | 48,692 |
| Cash and cash equivalents, end of period             | 39,485 | 22,660 | 62,145 |

(1) Includes  
intercompany  
working capital  
related  
transactions.

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**MERCER INTERNATIONAL INC.**  
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**(Unaudited)**

**(In thousands of Euros, except per share data)**

**Note 12. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Statement of Cash Flows**

|  | <b>Three Months Ended June 30, 2009</b> |                               |                               |
|--|---|-------------------------------|-------------------------------|
|  | <b>Restricted<br/>Group</b>             | <b>Unrestricted<br/>Group</b> | <b>Consolidated<br/>Group</b> |
| Cash flows from (used in) operating activities   |   |                               |                               |
| Net income (loss) attributable to common shareholders  | (11,279)                                | (197)                         | (11,476)                      |
| Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities |   |                               |                               |
| Loss (gain) on derivative instruments  |   | (7,451)                       | (7,451)                       |
| Foreign exchange loss (gain) on debt   | (5,170)                                 |                               | (5,170)                       |
| Depreciation and amortization  | 6,953                                   | 6,651                         | 13,604                        |
| Noncontrolling interest  |   | 3                             | 3                             |
| Deferred income taxes  | 1,135                                   | (3,023)                       | (1,888)                       |
| Stock compensation expense   | 26                                      |                               | 26                            |
| Pension and other post-retirement expense, net of funding  | (7)                                     |                               | (7)                           |
| Other  | 370                                     | 555                           | 925                           |
| Changes in current assets and liabilities  |   |                               |                               |
| Receivables  | 6,462                                   | (1,735)                       | 4,727                         |
| Inventories  | 9,715                                   | 11,691                        | 21,406                        |
| Accounts payable and accrued expenses  | 6,129                                   | 9,032                         | 15,161                        |
| Other <sup>(1)</sup>   | (1,348)                                 | 982                           | (366)                         |
| Net cash from (used in) operating activities   | 12,986                                  | 16,508                        | 29,494                        |
| Cash flows from (used in) investing activities   |   |                               |                               |
| Purchase of property, plant and equipment  | (7,352)                                 | (483)                         | (7,835)                       |
| Proceeds on sale of property, plant and equipment  | 46                                      | 57                            | 103                           |
| Note receivable  | 120                                     |                               | 120                           |
| Net cash from (used in) investing activities   | (7,186)                                 | (426)                         | (7,612)                       |
| Cash flows from (used in) financing activities   |   |                               |                               |
| Repayment of capital lease obligations   | (158)                                   | (378)                         | (536)                         |
| Net cash from (used in) financing activities   | (158)                                   | (378)                         | (536)                         |
| Effect of exchange rate changes on cash and cash equivalents   | (482)                                   |                               | (482)                         |
| Net increase (decrease) in cash and cash equivalents   | 5,160                                   | 15,704                        | 20,864                        |

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|  |        |        |        |
|--|--------|--------|--------|
| Cash and cash equivalents, beginning of period | 28,682 | 12,554 | 41,236 |
| Cash and cash equivalents, end of period       | 33,842 | 28,258 | 62,100 |

(1) Includes  
intercompany  
working capital  
related  
transactions.

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**MERCER INTERNATIONAL INC.**  
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**(Unaudited)**

**(In thousands of Euros, except per share data)**

**Note 12. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Statement of Cash Flows**

|  | <b>Six Months Ended June 30, 2010</b> |                               |                               |
|--|---------------------------------------|-------------------------------|-------------------------------|
|  | <b>Restricted<br/>Group</b>           | <b>Unrestricted<br/>Group</b> | <b>Consolidated<br/>Group</b> |
| Cash flows from (used in) operating activities   |                                       |                               |                               |
| Net income (loss) attributable to common shareholders  | 5,746                                 | (891)                         | 4,855                         |
| Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities |                                       |                               |                               |
| Loss (gain) on derivative instruments  |                                       | 11,008                        | 11,008                        |
| Foreign exchange loss (gain) on debt   | 14,602                                |                               | 14,602                        |
| Loss (gain) on extinguishment of convertible notes   | 929                                   |                               | 929                           |
| Depreciation and amortization  | 15,008                                | 12,989                        | 27,997                        |
| Accretion (income) expense   | 945                                   |                               | 945                           |
| Noncontrolling interest  |                                       | (115)                         | (115)                         |
| Stock compensation expense   | 733                                   |                               | 733                           |
| Pension and other post-retirement expense, net of funding  | 332                                   |                               | 332                           |
| Other  | 570                                   | 1,277                         | 1,847                         |
| Changes in current assets and liabilities  |                                       |                               |                               |
| Receivables  | (26,568)                              | (19,374)                      | (45,942)                      |
| Inventories  | 617                                   | (11,600)                      | (10,983)                      |
| Accounts payable and accrued expenses  | 7,722                                 | 5,610                         | 13,332                        |
| Other <sup>(1)</sup>   | (3,798)                               | 3,204                         | (594)                         |
| Net cash from (used in) operating activities   | 16,838                                | 2,108                         | 18,946                        |
| Cash flows from (used in) investing activities   |                                       |                               |                               |
| Purchase of property, plant and equipment  | (19,075)                              | (1,317)                       | (20,392)                      |
| Proceeds on sale of property, plant and equipment  | 63                                    | 486                           | 549                           |
| Note receivable  | 495                                   |                               | 495                           |
| Net cash from (used in) investing activities   | (18,517)                              | (831)                         | (19,348)                      |
| Cash flows from (used in) financing activities   |                                       |                               |                               |
| Repayment of notes payable and debt  |                                       | (8,250)                       | (8,250)                       |
| Repayment of capital lease obligations   | (584)                                 | (1,023)                       | (1,607)                       |
| Proceeds from borrowings of notes payable and debt   | 6,390                                 |                               | 6,390                         |
| Proceeds from government grants  | 10,559                                |                               | 10,559                        |
| Net cash from (used in) financing activities   | 16,365                                | (9,273)                       | 7,092                         |
| Effect of exchange rate changes on cash and cash equivalents   | 4,164                                 |                               | 4,164                         |

|  |        |         |        |
|--|--------|---------|--------|
| Net increase (decrease) in cash and cash equivalents | 18,850 | (7,996) | 10,854 |
| Cash and cash equivalents, beginning of period       | 20,635 | 30,656  | 51,291 |
| Cash and cash equivalents, end of period             | 39,485 | 22,660  | 62,145 |

(1) Includes  
intercompany  
working capital  
related  
transactions.

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**(Unaudited)**

**(In thousands of Euros, except per share data)**

**Note 12. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Statement of Cash Flows**

|  | <b>Six Months Ended June 30, 2009</b> |                               |                               |
|--|---------------------------------------|-------------------------------|-------------------------------|
|  | <b>Restricted<br/>Group</b>           | <b>Unrestricted<br/>Group</b> | <b>Consolidated<br/>Group</b> |
| Cash flows from (used in) operating activities   |                                       |                               |                               |
| Net income (loss) attributable to common shareholders  | (27,283)                              | (23,543)                      | (50,826)                      |
| Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities |                                       |                               |                               |
| Loss (gain) on derivative instruments  |                                       | 7,562                         | 7,562                         |
| Foreign exchange loss (gain) on debt   | (754)                                 |                               | (754)                         |
| Depreciation and amortization  | 13,723                                | 13,348                        | 27,071                        |
| Noncontrolling interest  |                                       | (9,258)                       | (9,258)                       |
| Deferred income taxes  | 909                                   | (5,828)                       | (4,919)                       |
| Stock compensation expense   | (8)                                   |                               | (8)                           |
| Pension and other post-retirement expense, net of funding  | (23)                                  |                               | (23)                          |
| Inventory provisions   | 3,233                                 | 1,354                         | 4,587                         |
| Other  | 350                                   | (2,324)                       | (1,974)                       |
| Changes in current assets and liabilities  |                                       |                               |                               |
| Receivables  | 22,215                                | 2,493                         | 24,708                        |
| Inventories  | 11,314                                | 16,211                        | 27,525                        |
| Accounts payable and accrued expenses  | 6,523                                 | 1,417                         | 7,940                         |
| Other <sup>(1)</sup>   | (12,463)                              | 13,097                        | 634                           |
| Net cash from (used in) operating activities   | 17,736                                | 14,529                        | 32,265                        |
| Cash flows from (used in) investing activities   |                                       |                               |                               |
| Purchase of property, plant and equipment  | (14,527)                              | (1,014)                       | (15,541)                      |
| Proceeds on sale of property, plant and equipment  | 98                                    | 134                           | 232                           |
| Cash, restricted   |                                       | 9,469                         | 9,469                         |
| Note receivable  | 241                                   |                               | 241                           |
| Net cash from (used in) investing activities   | (14,188)                              | 8,589                         | (5,599)                       |
| Cash flows from (used in) financing activities   |                                       |                               |                               |
| Repayment of notes payable and debt  | (5,550)                               | (8,250)                       | (13,800)                      |
| Repayment of capital lease obligations   | (301)                                 | (917)                         | (1,218)                       |
| Proceeds from borrowings of notes payables and debt  | 10,000                                |                               | 10,000                        |
| Payment of deferred note issuance costs  |                                       | (1,969)                       | (1,969)                       |
| Net cash from (used in) financing activities   | 4,149                                 | (11,136)                      | (6,987)                       |

|  |        |        |        |
|--|--------|--------|--------|
| Effect of exchange rate changes on cash and cash equivalents | (31)   |        | (31)   |
| Net increase (decrease) in cash and cash equivalents         | 7,666  | 11,982 | 19,648 |
| Cash and cash equivalents, beginning of period               | 26,176 | 16,276 | 42,452 |
| Cash and cash equivalents, end of period                     | 33,842 | 28,258 | 62,100 |

(1) Includes  
intercompany  
working capital  
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 International Inc. and its subsidiaries; (ii) references to Mercer Inc. mean the Company excluding its subsidiaries; (iii) information is provided as of June 30, 2010, 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; and (vi) ADMTs refers to air-metric tonnes.

**Results of Operations**

***General***

We operate three northern bleached softwood kraft ( 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, 2010 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, 2009 filed with the Securities and Exchange Commission (the SEC ).

***Market Environment***

Global pulp markets continued to strengthen as global economies have shown signs of recovery in the first half of 2010. Pulp prices have also increased significantly as worldwide demand has outstripped supply in many regions, including Europe. In addition, the strengthening of the U.S. dollar relative to the Euro in 2010 has improved the operating margins of our German mills.

Although we experienced low pulp inventories in the first half of 2010, which historically have signaled price increases, and global softwood pulp stocks are still tight at approximately 21 days, we are seeing signs of reduced demand out of the Chinese market, which, along with the traditional summer slowdown, has resulted in downward pulp pricing in July which may continue into the third quarter.

In the third quarter, we have 12 days of scheduled maintenance downtime at our Rosenthal mill. In addition, the turbine at the Rosenthal mill will be down for maintenance for approximately an additional 51 days, which was extended from 38 days to accommodate some preventative maintenance on the generator unit. During the turbine downtime, the Rosenthal mill will produce pulp at full capacity but will purchase energy instead of selling surplus energy. We have no scheduled maintenance downtime for the fourth quarter of 2010.

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Selected production, sales and exchange rate data for the three and six months ended June 30, 2010 and 2009 is as follows:

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
| Pulp Production ( 000 ADMTs)               | 359.7                     | 349.1       | 689.1                   | 694.7       |
| Scheduled Production Downtime ( 000 ADMTs) | 17.0                      | 2.7         | 35.2                    | 2.7         |
| Pulp Sales ( 000 ADMTs)                    | 365.0                     | 395.4       | 697.9                   | 732.0       |
| Pulp Revenues (in millions)                | 228.3                     | 147.5       | 399.4                   | 276.6       |
| NBSK pulp list prices in Europe (\$/ADMT)  | \$ 957                    | \$ 602      | \$ 908                  | \$ 593      |
| NBSK pulp list prices in Europe ( /ADMT)   | 752                       | 442         | 684                     | 445         |
| Average pulp sales realizations ( /ADMT)   | 618                       | 367         | 565                     | 372         |
| <br>                                       |                           |             |                         |             |
| Energy Production ( 000 MWh)               | 382.5                     | 376.0       | 720.3                   | 732.3       |
| Energy Sales ( 000 MWh)                    | 144.2                     | 128.5       | 251.3                   | 240.8       |
| Energy Revenue (in millions)               | 11.9                      | 11.4        | 21.1                    | 21.9        |
| Average energy sales realizations ( /MWh)  | 83                        | 88          | 84                      | 91          |
| <br>                                       |                           |             |                         |             |
| Average Spot Currency Exchange Rates       |                           |             |                         |             |
| /(\$)                                      | 0.7865                    | 0.7347      | 0.7547                  | 0.7511      |
| C\$ / \$( <sup>2</sup> )                   | 1.0277                    | 1.1678      | 1.0345                  | 1.2063      |
| C\$ / ( <sup>3</sup> )                     | 1.3073                    | 1.5890      | 1.3739                  | 1.6054      |

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



***Three Months Ended June 30, 2010 Compared to Three Months Ended June 30, 2009***

Pulp revenues for the three months ended June 30, 2010 increased by approximately 54.8% to 228.3 million from 147.5 million in the comparative quarter of 2009, primarily due to significantly higher pulp prices and a stronger U.S. dollar relative to the Euro. Revenues from the sale of excess energy increased slightly by approximately 4.4% in the second quarter to 11.9 million from 11.4 million in the same quarter last year, primarily due to our German mills reaching record levels of production.

Pulp prices in the second quarter of 2010 were significantly higher than in the same period last year due to a strengthening in global pulp markets. List prices for NBSK pulp in Europe were approximately \$957 ( 752) per ADMT in the current quarter compared to approximately \$602 ( 442) per ADMT in the second quarter of 2009 and \$800 ( 558) at the end of 2009. In the second quarter of 2010, average pulp sales realizations increased by approximately 68.4% to 618 per ADMT from 367 per ADMT in the same period last year, primarily due to significantly higher pulp prices. Pulp sales volume decreased to 365,002 ADMTs in the current quarter from 395,378 ADMTs in the comparative period of 2009, due to unusually high sales to China in the second quarter of 2009.

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Pulp production increased to 359,694 ADMTs in the current quarter from 349,129 ADMTs in the same quarter of 2009, primarily due to record levels of production at our German mills, being partially offset by the 12 days (approximately 17,000 ADMTs) of scheduled maintenance downtime at our Celgar mill. In the comparative quarter of 2009, we had three days of scheduled maintenance downtime.

Costs and expenses in the second quarter of 2010 increased to 192.3 million from 168.6 million in the comparative period of 2009, primarily due to increased fiber costs and the costs associated with annual maintenance at the Celgar mill.

In the second quarter of 2010, operating depreciation and amortization increased slightly to 14.1 million from 13.5 million in the same quarter last year. Selling, general and administrative expenses increased to 10.0 million from 6.0 million in the second quarter of 2009, primarily as a result of foreign exchange effects on certain foreign currency denominated balances.

Transportation costs increased by approximately 12.6% to 17.0 million in the second quarter of 2010 from 15.1 million in the second quarter of the same period in 2009, primarily due to higher container rates.

Overall, our fiber costs increased by approximately 31.3% in the second quarter of 2010 from the same period in 2009, primarily due to higher fiber costs at our German mills, resulting mainly from low harvesting rates and sawmill activity leading to lower fiber availability and increased demand from the European board industry.

For the second quarter of 2010, we recorded operating income of 47.9 million compared to an operating loss of 9.7 million in the comparative quarter of 2009, primarily due to significantly improved pulp prices and a stronger U.S. dollar relative to the Euro.

Interest expense in the second quarter of 2010 increased marginally to 16.9 million from 16.3 million in the comparative quarter of 2009, due to the accretion expense related to the exchange of our convertible notes in January 2010 and our interest payments on our U.S. dollar denominated debt being slightly higher when expressed in Euros, as a result of the strengthening of the U.S. dollar relative to the Euro.

Our Stendal mill recorded an unrealized loss of 4.5 million on the mark to market of its interest rate derivatives at the end of the current quarter, compared to an unrealized gain of 7.5 million in the same period last year.

In the second quarter of 2010, we recorded a foreign exchange loss of 9.4 million on our foreign currency denominated debt compared to a gain of 5.2 million in the same period of 2009.

In the second quarter of 2010, the noncontrolling shareholder's interest in the Stendal mill's income was 3.6 million, compared to a negligible amount of income in the same quarter last year.

We reported net income attributable to common shareholders for the second quarter of 2010 of 12.4 million, or 0.34 per basic and 0.23 per diluted share, which included aggregate non-cash, unrealized losses of 13.8 million, or 0.38 per basic share, on the Stendal interest derivatives and foreign exchange loss on our debt. In the second quarter of 2009, net loss attributable to common shareholders was 11.5 million, or 0.32 per basic and diluted share, which included an aggregate non-cash, unrealized gain of 12.6 million, or 0.35 per basic share, on the Stendal interest rate derivatives and foreign exchange gains on our debt.

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Operating EBITDA in the second quarter of 2010 increased to 62.1 million from 31.8 million in the prior quarter and 3.9 million in the second quarter of 2009. 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 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 ( GAAP ), and should not be considered as an alternative to net income (loss) or income (loss) from operations as a measure of performance, nor as an alternative to net cash from operating activities as a measure of liquidity.

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

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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</b> |             |
|---|---------------------------|-------------|
|   | <b>June 30,</b>           |             |
|   | <b>2010</b>               | <b>2009</b> |
|   | <b>(in thousands)</b>     |             |
| Net income (loss) attributable to common shareholders     | 12,401                    | (11,476)    |
| Net income (loss) attributable to noncontrolling interest | 3,554                     | 3           |
| Income taxes (benefits)                                   | 1,319                     | (1,823)     |
| Interest expense  | 16,898                    | 16,319      |
| Investment (income) loss                                  | (117)                     | (138)       |
| Foreign exchange loss (gain) on debt                      | 9,371                     | (5,170)     |
| Loss (gain) on derivative instruments                     | 4,462                     | (7,451)     |
| <br>  |                           |             |
| Operating income (loss)                                   | 47,888                    | (9,736)     |
| Add: Depreciation and amortization                        | 14,176                    | 13,604      |
| <br>  |                           |             |
| Operating EBITDA  | 62,064                    | 3,868       |

***Six Months Ended June 30, 2010 Compared to Six Months Ended June 30, 2009***

Pulp revenues for the six months ended June 30, 2010 increased by approximately 44.4% to 399.4 million from 276.6 million in the comparative period of 2009, primarily due to significantly higher pulp prices and a stronger U.S. dollar relative to the Euro. Revenues from the sale of excess energy marginally decreased by approximately 3.7% in the first half of 2010 to 21.1 million from 21.9 million in the comparative period last year, primarily due to the absence of a one-time grid access fee rebate received in 2009.

Pulp prices in the first half of 2010 were higher than in the same period last year due to a strengthening in global pulp markets. List prices for NBSK pulp in Europe were approximately \$908 ( 684) per ADMT in the first half of 2010 compared to approximately \$593 ( 445) per ADMT in the first half of 2009. In the first six months of 2010, average pulp sales realizations increased by approximately 51.9% to 565 per ADMT from 372 per ADMT in the same period last year, primarily due to significantly higher pulp prices.

Pulp sales volume decreased to 697,871 ADMTs in the first half of 2010 from 732,037 ADMTs in the comparative period of 2009.

Pulp production decreased slightly to 689,149 ADMTs in the first six months of 2010 from 694,749 ADMTs in the comparative period of 2009, primarily due to scheduled maintenance downtime at our Stendal and Celgar mills. After adjusting for scheduled maintenance, production was approximately 30,000 ADMTs higher during the first six months of 2010 from the comparable period of 2009. We experienced 10 days of scheduled maintenance downtime and resulting production curtailments of approximately 18,170 tonnes at our Stendal mill in the first quarter of 2010 and 12 days of scheduled maintenance downtime and resulting production curtailments of approximately 17,000 tonnes at our Celgar mill in the second quarter of 2010, compared to an aggregate of three days of maintenance downtime and resulting production curtailments of approximately 2,700 tonnes at all of our mills in the first half of 2009.

Costs and expenses in the first half of 2010 increased to 354.6 million from 320.6 million in the comparative period of 2009, primarily due to higher fiber costs in Germany, and the costs associated with annual maintenance at the Stendal and Celgar mills.

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In the six months ended June 30, 2010, operating depreciation and amortization increased slightly to 27.8 million from 26.9 million in the same period last year. Selling, general and administrative expenses increased in the first half of 2010 to 18.1 million from 13.2 million in the comparative period of 2009, primarily as a result of foreign exchange effects on certain foreign currency denominated balances.

Transportation costs increased by approximately 8.3% to 31.3 million in the first half of 2010 from 28.9 million in the first half of 2009, primarily due to higher container rates.

Overall, our fiber costs increased by approximately 18.8% in the first half of 2010 from the same period in 2009, primarily due to higher fiber costs at our German mills resulting from increased demand from the European board industry. At our Celgar mill, an increase in the supply of lower cost residual fiber and a corresponding decrease in fiber from third party chippers was more than offset by the stronger Canadian dollar relative to the Euro.

For the first half of 2010, we recorded operating income of 65.9 million compared to an operating loss of 22.1 million in the comparative period of 2009, primarily due to significantly higher pulp price realizations.

Interest expense in the first half of 2010 increased marginally to 33.3 million from 32.9 million in the comparative period of 2009, due to accretion expense related to the exchange of our convertible notes in January 2010, being partially offset by lower debt levels at our Stendal mill.

Our Stendal mill recorded an unrealized loss of 11.0 million on the mark to market of its interest rate derivatives at the period ended June 30, 2010, compared to an unrealized loss of 7.6 million in the same period last year.

In the first half of 2010, we recorded a foreign exchange loss of 14.6 million on our foreign currency denominated debt compared to a gain of 0.8 million in the same period of 2009.

In the first half of 2010, we completed an exchange (the Exchange) of approximately 15.4 million (\$21.7 million) in aggregate principal amount of our 8.5% Convertible Senior Subordinated Notes due 2010 (the 2010 Convertible Notes) for new 8.5% Convertible Senior Subordinated Notes due 2012 (the 2012 Convertible Notes). We recorded a loss of approximately 0.9 million on the extinguishment of the 2010 Convertible Notes.

In the first six months of 2010, the noncontrolling shareholder's interest in the Stendal mill's loss was 0.1 million, compared to a loss of 9.3 million in the same period last year.

We reported net income attributable to common shareholders for the first six months of 2010 of 4.9 million, or 0.13 per basic and 0.11 per diluted share, which included aggregate non-cash, unrealized losses of 25.6 million on the Stendal interest derivatives and foreign exchange loss on our debt. In the first six months of 2009, the net loss attributable to common shareholders was 50.8 million, or 1.40 per basic and diluted share, which included net unrealized losses on the Stendal interest rate derivatives and the foreign exchange translation on our debt of 6.8 million.

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Operating EBITDA increased to \$93.9 million in the first half of 2010 compared to Operating EBITDA of \$4.9 million in the six months ended June 30, 2009. 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, 2010 for additional information relating to such limitations and Operating EBITDA.

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>Six Months Ended<br/>June 30,</b> |             |
|---|--------------------------------------|-------------|
|   | <b>2010</b>                          | <b>2009</b> |
|   | <b>(in thousands)</b>                |             |
| Net income (loss) attributable to common shareholders     | 4,855                                | (50,826)    |
| Net income (loss) attributable to noncontrolling interest | (115)                                | (9,258)     |
| Income taxes (benefits)                                   | 1,523                                | (4,805)     |
| Interest expense  | 33,321                               | 32,868      |
| Investment (income) loss                                  | (211)                                | 3,064       |
| Foreign exchange loss (gain) on debt                      | 14,602                               | (754)       |
| Loss on extinguishment of convertible notes               | 929                                  |             |
| Loss (gain) on derivative instruments                     | 11,008                               | 7,562       |
| Operating income (loss)                                   | 65,912                               | (22,149)    |
| Add: Depreciation and amortization                        | 27,997                               | 27,071      |
| Operating EBITDA  | 93,909                               | 4,922       |

**Liquidity and Capital Resources**

The following table is a summary of selected financial information for the periods indicated:

|                               | <b>As at<br/>June 30,<br/>2010</b> | <b>As at<br/>December 31,<br/>2009</b> |
|-------------------------------|------------------------------------|--|
|                               | <b>(in thousands)</b>              |  |
| <b>Financial Position</b>     |                                    |  |
| Cash and cash equivalents     | 62,145                             | 51,291                                 |
| Working capital               | 155,388                            | 99,150                                 |
| Property, plant and equipment | 872,843                            | 868,558                                |
| Total assets                  | 1,170,812                          | 1,083,831                              |
| Long-term liabilities         | 941,775                            | 896,074                                |
| Total equity                  | 100,145                            | 85,973                                 |

**Sources and Uses of Funds**

Our principal sources of funds are cash flows from operations, cash 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 facility relating to our Stendal mill ( Stendal Loan Facility ), capital expenditures and interest payments on our outstanding 9.25% senior notes ( Senior Notes ) and the 2012 Convertible Notes.

In the last quarter of 2009 our Celgar mill was allocated approximately C\$57.7 million in credits under the Canadian government's Pulp and Paper Green Transformation Program (the GTP ). The GTP's objective is to improve the

environmental performance of Canada's pulp and paper industry by funding, by way of government grants, approved capital projects with environmental benefits, such as investments in energy efficiency. Subsequently, in November 2009, we entered into a non-repayable contribution agreement with the Department of Natural Resources Canada ( NRCan ) whereby NRCan agreed to provide approximately C\$40.0 million ( 30.7 million) in grants towards certain costs associated with our green energy project at our Celgar mill (the Celgar Energy Project ).

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In the first six months of 2010, capital expenditures related to the Celgar Energy Project totaled approximately 15.7 million (C\$21.6 million) and we expect the remaining costs for the project to be approximately 9.7 million (C\$12.6 million), substantially all of which will be financed through the C\$40.0 million grant from the Canadian federal government under the GTP.

As at June 30, 2010, our cash and cash equivalents were approximately 62.1 million, compared to approximately 51.3 million at the end of 2009 and we had working capital of approximately 155.4 million compared to approximately 99.2 million at the end of 2009.

***Debt Covenants***

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

As at June 30, 2010, we were in full compliance with all of the covenants of our indebtedness.

***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, chemicals and debt service.

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.

Operating activities provided cash of 18.9 million and 32.3 million in the six months ended June 30, 2010 and 2009, respectively, primarily due to the impact of operating results and working capital movements. An increase in receivables used cash of 45.9 million in the first six months of 2010, compared to a decrease in receivables providing cash of 24.7 million in the first six months of 2009. An increase in inventories used cash of 11.0 million in the first six months of 2010, compared to a decrease in inventories before non-cash provisions providing cash of 27.5 million in the first six months of 2009. An increase in accounts payable and accrued expenses provided cash of 13.3 million in the first six months of 2010, compared to an increase in accounts payable and accrued expenses providing cash of 7.9 million in the first six months of 2009.

***Cash Flows from Investing Activities.*** Investing activities in the first six months of 2010 used cash of 19.3 million, compared to using cash of 5.6 million in the same period of 2009. Capital expenditures in the first six months of 2010 used cash of 20.4 million primarily for the Celgar Energy Project, compared to 15.5 million in the same period of 2009.

***Cash Flows from Financing Activities.*** In the first half of 2010, financing activities provided cash of 7.1 million, compared to using cash of 7.0 million in the same period last year. Repayment of indebtedness and leases used cash of 9.9 million and 15.0 million in the six months ended June 30, 2010 and 2009, respectively. The six months ended June 30, 2010 also included government grants primarily for our Celgar Energy Project, which provided cash of 10.6 million.

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***Capital Resources***

Other than commitments totaling approximately 9.7million relating to the Celgar Energy Project to be completed in the fourth quarter of 2010, we have no material commitments to acquire assets or operating businesses. We expect the remaining costs to complete the Celgar Energy Project to be funded from government funding credits under the GTP.

***Future Liquidity***

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.

***Contractual Obligations and Commitments***

There were no material changes outside the ordinary course to any of our contractual obligations during the first half of 2010.

***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. 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. Unrealized gains or losses from these translations are recorded in our consolidated statement of comprehensive income and impact on shareholders' equity on the balance sheet but do not affect our net earnings.

In the six months ended June 30, 2010, accumulated other comprehensive income increased by 2.4 million to 26.1 million, primarily due to the foreign exchange translation.

Based upon the exchange rate at June 30, 2010, the U.S. dollar strengthened by approximately 14.1% in value against the Euro since June 30, 2009. See Quantitative and Qualitative Disclosures about Market Risk .

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

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.

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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.

***Restricted Group Results Three Months Ended June 30, 2010 Compared to Three Months Ended June 30, 2009***

Pulp revenues for the Restricted Group for the three months ended June 30, 2010 increased by approximately 63.4% to 124.8 million from 76.4 million in the comparative period of 2009, primarily due to significantly higher pulp prices and a stronger U.S. dollar relative to the Euro. Revenues from the sale of excess energy marginally decreased by approximately 2.6% in the current quarter to 3.8 million from 3.9 million in the same period last year, primarily due to the absence of a one-time grid access fee rebate received in 2009.

Pulp prices were significantly higher in the second quarter of 2010 than in the same period last year due to continued strengthening in global pulp markets. List prices for NBSK pulp in Europe were approximately \$957 ( 752) per ADMT in the current quarter compared to approximately \$602 ( 442) per ADMT in the second quarter of 2009. In the second quarter of 2010, average pulp sales realizations for the Restricted Group increased by approximately 66.0% to 621 per ADMT from 374 per ADMT in the same period last year.

Pulp sales volume of the Restricted Group marginally decreased to 200,680 ADMTs in the second quarter of 2010 from 203,989 ADMTs in the comparative period of 2009.

Pulp production for the Restricted Group increased slightly to 193,697 ADMTs in the second quarter of 2010 from 188,183 ADMTs in the same period of 2009, primarily as a result of near record production levels at our Rosenthal mill, partially offset by 12 days (approximately 17,000 tonnes) of scheduled maintenance downtime at our Celgar mill.

Costs and expenses for the Restricted Group in the second quarter of 2010 increased to 110.2 million from 90.0 million in the comparative period of 2009, primarily due to increased fiber costs and the costs associated with annual maintenance at our Celgar mill.

In the second quarter of 2010 operating depreciation and amortization for the Restricted Group increased to 7.6 million from 6.9 million in the same period last year. Selling, general and administrative expenses for the Restricted Group increased to 6.7 million from 3.3 million in the comparative period of 2009, primarily as a result of foreign exchange effects on certain foreign currency denominated balances.

Transportation costs for the Restricted Group increased by approximately 27.9% to 12.6 million in the second quarter of 2010 from 9.8 million in the same period of 2009, primarily due to higher container rates.

Overall, fiber costs of the Restricted Group in the second quarter of 2010 increased by approximately 22.2% compared to the same period of 2009, primarily due to increased German fiber prices.

In the second quarter of 2010, the Restricted Group reported operating income of 18.5 million compared to an operating loss of 9.6 million in the second quarter of 2009, primarily due to significantly higher pulp realizations.

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Interest expense for the Restricted Group increased to 8.0 million in the second quarter from 6.9 million in the same quarter last year, primarily due to the accretion expense related to the Exchange.

In the second quarter of 2010, the Restricted Group recorded a loss on foreign currency denominated debt of 9.4 million, compared to a gain of 5.2 million in the comparative quarter of 2009.

The Restricted Group reported net income for the second quarter of 2010 of 2.1 million compared to a net loss of 11.3 million in the same period last year.

In the second quarter of 2010, the Restricted Group reported Operating EBITDA of 26.2 million compared to an Operating EBITDA loss of 2.7 million in the comparative quarter of 2009 and Operating EBITDA of 23.4 million in the first quarter of 2010. 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, 2010 for additional information relating to such limitations and Operating EBITDA.

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

|                                       | <b>Three Months Ended<br/>June 30,</b> |             |
|---------------------------------------|--|-------------|
|                                       | <b>2010</b>                            | <b>2009</b> |
|                                       | <b>(in thousands)</b>                  |             |
| <b>Restricted Group<sup>(1)</sup></b> |  |             |
| Net income (loss)                     | 2,075                                  | (11,279)    |
| Income taxes (benefits)               | 334                                    | 1,149       |
| Interest expense                      | 7,957                                  | 6,927       |
| Investment (income) loss              | (1,285)                                | (1,234)     |
| Foreign exchange (gain) loss on debt  | 9,371                                  | (5,170)     |
| Operating income (loss)               | 18,452                                 | (9,607)     |
| Add: Depreciation and amortization    | 7,698                                  | 6,953       |
| Operating EBITDA                      | 26,150                                 | (2,654)     |

(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, 2010 Compared to Six Months Ended June 30, 2009**

Pulp revenues for the Restricted Group for the six months ended June 30, 2010 increased by approximately 52.7% to 231.3 million from 151.5 million in the comparative period of 2009, primarily due to significantly higher pulp prices. Revenues from the sale of excess energy decreased slightly by approximately 10.0% in the first half of 2010 to

7.2 million from 8.0 million in the same period last year, primarily due to the absence of a one-time grid access fee rebate received in 2009.

Pulp prices were higher in the first half of 2010 than in the same period last year due to continued strengthening in global pulp markets. List prices for NBSK pulp in Europe were approximately \$908 ( 684) per ADMT in the first six months of 2010 compared to approximately \$593 ( 445) per ADMT in the first half of 2009. In the first half of 2010, average pulp sales realizations for the Restricted Group increased by approximately 48.9% to 566 per ADMT from 380 per ADMT in the same period last year.

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Pulp sales volume of the Restricted Group increased to 408,111 ADMTs in the first half of 2010 from 397,780 ADMTs in the comparative period of 2009.

Pulp production for the Restricted Group increased to 404,033 ADMTs in the first six months of 2010 from 387,612 ADMTs in the same period of 2009, primarily as a result of improved mill reliability. In the first half of 2010, our Celgar mill had 12 days (approximately 17,000 ADMTs) of scheduled maintenance downtime, compared to only three days (approximately 2,700 ADMTs) of maintenance downtime in the first half of 2009.

Costs and expenses for the Restricted Group in the first six months of 2010 increased to 203.9 million from 174.4 million in the comparative period of 2009, primarily due to higher fiber costs in Germany and the costs associated with annual maintenance at our Celgar mill.

In the first half of 2010 operating depreciation and amortization for the Restricted Group increased to 14.8 million from 13.6 million in the same period last year. Selling, general and administrative expenses increased to 11.6 million from 7.2 million in the comparative period of 2009, primarily as a result of foreign exchange effects on certain foreign currency denominated balances.

Transportation costs for the Restricted Group increased by 18.7% to 23.8 million in the first half of 2010 from 20.1 million in the first half of 2009, primarily due to higher container rates.

Overall, fiber costs of the Restricted Group increased by 13.2% in the first half of 2010 compared to the same period of 2009, primarily due to increased German fiber prices.

In the first six months of 2010, the Restricted Group reported operating income of 34.5 million compared to an operating loss of 15.0 million in the first six months of 2009, primarily due to significantly higher pulp realizations.

Interest expense of 15.3 million for the Restricted Group increased in the first half of 2010 from 14.2 million in the first half of 2009, primarily due to the accretion expense related to the Exchange.

In the first six months of 2010, the Restricted Group recorded a loss on foreign currency denominated debt of 14.6 million, compared to a gain of 0.8 million in the comparative period of 2009.

During the first six months of 2010, in connection with the Exchange, the Restricted Group recorded a loss of approximately 0.9 million on the extinguishment of the 2010 Convertible Notes.

The Restricted Group reported net income for the first six months of 2010 of 5.7 million compared to a net loss of 27.3 million in the first six months of 2009.

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In the first half of 2010, the Restricted Group reported Operating EBITDA of \$49.5 million compared to an Operating EBITDA loss of \$1.3 million in the comparative period of 2009. 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, 2010 for additional information relating to such limitations and Operating EBITDA.

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

|   | <b>Six Months Ended</b> |             |
|---|-------------------------|-------------|
|   | <b>June 30,</b>         |             |
|   | <b>2010</b>             | <b>2009</b> |
|   | <b>(in thousands)</b>   |             |
| <b>Restricted Group<sup>(1)</sup></b>       |                         |             |
| Net income (loss)                           | 5,746                   | (27,283)    |
| Income taxes (benefits)                     | 495                     | 941         |
| Interest expense                            | 15,277                  | 14,229      |
| Investment (income) loss                    | (2,524)                 | (2,150)     |
| Foreign exchange (gain) loss on debt        | 14,602                  | (754)       |
| Loss on extinguishment of convertible notes | 929                     |             |
| <br>  |                         |             |
| Operating income (loss)                     | 34,525                  | (15,017)    |
| Add: Depreciation and amortization          | 15,008                  | 13,723      |
| <br>  |                         |             |
| Operating EBITDA                            | 49,533                  | (1,294)     |

(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 for the periods indicated:

|  | <b>As at</b>          | <b>As at</b>        |
|--|-----------------------|---------------------|
|  | <b>June 30,</b>       | <b>December 31,</b> |
|  | <b>2010</b>           | <b>2009</b>         |
|  | <b>(in thousands)</b> |                     |
| <b>Restricted Group Financial Position<sup>(1)</sup></b> |                       |                     |
| Cash and cash equivalents                                | 39,485                | 20,635              |
| Working capital  | 102,650               | 57,015              |

|                               |         |         |
|-------------------------------|---------|---------|
| Property, plant and equipment | 378,462 | 362,311 |
| Total assets                  | 635,334 | 555,977 |
| Long-term liabilities         | 357,172 | 301,173 |
| Total equity                  | 209,149 | 200,247 |

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

At June 30, 2010, the Restricted Group had cash and cash equivalents of approximately 39.5 million, compared to approximately 20.6 million at the end of 2009 and had working capital of approximately 102.7 million compared to working capital of approximately 57.0 million at the end of 2009. The increase in working capital was primarily due to the impact of higher sales realizations on accounts receivable in 2010.

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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*Credit Ratings*

Standard & Poor's Rating Services ( S&P ) and Moody's Investors Service, Inc. ( Moody's ) base their assessment of our credit risk on the business and financial profile of the Restricted Group only. Factors that may affect our credit rating include changes in our operating performance and liquidity. Credit rating downgrades can adversely impact, among other things, future borrowing costs and access to capital markets.

During the second quarter of 2010, we were subject to improved rating actions by Moody's and S&P. In May 2010, S&P raised its target credit rating from B- to B with a stable ratings outlook to reflect temporary pulp supply shortages and the strengthening of pulp markets. S&P believes that we should be able to maintain sufficient liquidity to support this new credit rating. The B rating also reflects the expectation that we will continue to benefit from favorable foreign exchange rates resulting from the strength of the U.S. dollar relative to the Euro.

In June 2010, Moody's upgraded our Corporate Family Rating ( CFR ) to B3 from Caa1, and upgraded its ratings outlook to positive, citing the positive impact of recent pulp price increases on our liquidity, financial structure, and operating results.

**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 disclosure. 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, 2009. 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 pensions and post-retirement benefits, provisions for bad debt and doubtful accounts, derivative instruments, impairment of long-lived assets, deferred taxes, inventory provisions and environmental conservation and legal liabilities. Actual results could differ from these estimates.

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, 2009.

**New Accounting Standards**

See Note 1 to the Company's interim consolidated financial statements included in Item 1.

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**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. These statements appear in a number of different places in this report and can be identified by words such as estimates, projects, expects, intends, believes, plans, or their negatives or other comparable words. Also look for discussions of strategies that involve risks and uncertainties. Forward-looking statements include statements regarding:

our markets;

demand and prices for our products;

our level of indebtedness;

raw material costs and supply;

energy prices, sales and our initiatives to enhance sales of surplus energy;

capital expenditures;

the economy;

foreign exchange rates particularly the U.S. dollar and Canadian dollar; and

derivatives.

You are cautioned that any such forward-looking statements are not guarantees and may involve risks and uncertainties. Our actual results may differ materially from those in the forward-looking statements due to risks facing us or due to actual facts differing from the assumptions underlying our estimates. Some of these risks and assumptions include 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, 2009. 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 for our principal products are characterized by periods of supply and demand imbalance, which in turn affects product 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.

Industry capacity can fluctuate as changing industry conditions can influence producers to idle production or permanently close machines or entire 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.

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Demand for pulp has historically been determined by the level of economic growth and has been closely tied to overall business activity. From 2006 to mid-2008, pulp prices in Europe steadily improved. However, in the latter half of 2008, a global economic crisis resulted in a sharp decline of European pulp prices from a high of \$900 per ADMT to \$635 per ADMT at the end of 2008. Beginning in the second quarter of 2009 prices began to improve, rising from a low of \$575 per ADMT in March 2009 to \$980 per ADMT at the end of the second quarter of 2010. In the third quarter of 2010 to date, pulp prices have faced downward pressure due to reduced demand in China and traditionally slower summer months. Additionally, although global softwood pulp stocks currently remain generally tight at approximately 21 days, a further deterioration in prices may occur in the future.

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, such pulp 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. Fiber costs are primarily affected by the supply of, and demand for, lumber which is highly cyclical in nature and can vary significantly by location. Production costs also depend on the total volume of production. Lower operating rates and production efficiencies 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. Conversely, an increase in the U.S. dollar versus the Euro and the Canadian dollar positively impacts our revenues by increasing our operating margins and cash flow.

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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 rate 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, from time to time, currency risks. We may in the future use derivatives to reduce or limit our exposure to fluctuations in pulp prices. We also 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 are 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 first six months of 2010, we recorded an unrealized loss of \$11.0 million on our outstanding interest rate derivatives compared to an unrealized loss of \$7.6 million in the comparative period of 2009.

We are also subject to some energy price risk, primarily for 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 (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, 2009. 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**

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, 2009.

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

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

**Exhibit No. Description**

|       |  |
|-------|--|
| 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 |

\* 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 5, 2010  
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