

MERCER INTERNATIONAL INC.

Form 10-Q

November 04, 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 September 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)*

**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)*

**47-0956945**

*(I.R.S. Employer  
Identification No.)*

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 42,029,660 shares of common stock outstanding as at November 3, 2010.

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

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

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

	<b>September 30, 2010</b>	<b>December 31, 2009</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	85,126	51,291
Receivables	101,920	71,143
Inventories (Note 4)	112,385	72,629
Prepaid expenses and other	11,986	5,871
Total current assets	311,417	200,934
Long-term assets		
Property, plant and equipment	851,736	868,558
Deferred note issuance and other	6,941	8,186
Deferred income tax	12,990	3,426
Note receivable	1,723	2,727
	873,390	882,897
Total assets	1,184,807	1,083,831
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and accrued expenses	108,130	85,185
Pension and other post-retirement benefit obligations (Note 7)	608	567
Debt (Note 5)	25,928	16,032
Total current liabilities	134,666	101,784
Long-term liabilities		
Debt (Note 5)	790,750	813,142
Unrealized interest rate derivative losses (Notes 6 and 9)	63,396	52,873
Pension and other post-retirement benefit obligations (Note 7)	19,581	17,902
Capital leases and other	10,558	12,157
	884,285	896,074
Total liabilities	1,018,951	997,858
<b>EQUITY</b>		
Shareholders' equity		

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Share capital (Note 8)	216,791	202,844
Paid-in capital	(4,929)	(6,082)
Retained earnings (deficit)	(46,245)	(97,235)
Accumulated other comprehensive income (loss)	26,211	23,695
Total shareholders' equity	191,828	123,222
Noncontrolling interest (deficit) (Note 10)	(25,972)	(37,249)
Total equity	165,856	85,973
Total liabilities and equity	1,184,807	1,083,831

Commitments and contingencies (Note 11)

Subsequent Events (Note 12)

*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>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Revenues				
Pulp	224,697	145,857	624,111	422,412
Energy	9,721	10,374	30,783	32,275
	234,418	156,231	654,894	454,687
Costs and expenses				
Operating costs	162,293	136,566	470,977	417,596
Operating depreciation and amortization	13,987	13,385	41,817	40,325
	58,138	6,280	142,100	(3,234)
Selling, general and administrative expenses	6,894	6,620	24,944	19,797
Purchase (sale) of emission allowances	(167)	153	(167)	(389)
Operating income (loss)	51,411	(493)	117,323	(22,642)
Other income (expense)				
Interest expense	(17,820)	(16,085)	(51,141)	(48,953)
Investment income (loss)	93	20	304	(3,044)
Foreign exchange gain (loss) on debt	9,927	3,779	(4,675)	4,533
Gain (loss) on extinguishment of convertible notes (Note 5)			(929)	
Gain (loss) on derivative instruments (Note 6)	485	(3,327)	(10,523)	(10,889)
Total other income (expense)	(7,315)	(15,613)	(66,964)	(58,353)
Income (loss) before income taxes	44,096	(16,106)	50,359	(80,995)
Income tax benefit (provision) current	(2,227)	(13)	(3,750)	(127)
deferred	9,382	70	9,382	4,989
Net income (loss)	51,251	(16,049)	55,991	(76,133)
Less: net loss (income) attributable to noncontrolling interest	(5,116)	1,937	(5,001)	11,195
Net income (loss) attributable to common shareholders	46,135	(14,112)	50,990	(64,938)
Net income (loss) per share attributable to common shareholders (Note 3)				
Basic	1.17	(0.39)	1.36	(1.79)
Diluted	0.82	(0.39)	0.93	(1.79)

*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>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Net income (loss) attributable to common shareholders	46,135	(14,112)	50,990	(64,938)
Retained earnings (deficit), beginning of period	(92,380)	(85,872)	(97,235)	(35,046)
Retained earnings (deficit), end of period	(46,245)	(99,984)	(46,245)	(99,984)

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Net income (loss)	51,251	(16,049)	55,991	(76,133)
Other comprehensive income (loss)				
Foreign currency translation adjustment	(134)	14,531	2,809	23,758
Pension income (expense)	317	(41)	(282)	(73)
Unrealized gains (losses) on securities arising during the period	(29)	42	(11)	377
Other comprehensive income (loss)	154	14,532	2,516	24,062
Total comprehensive income (loss)	51,405	(1,517)	58,507	(52,071)
Comprehensive loss (income) attributable to noncontrolling interest	(5,116)	1,937	(5,001)	11,195
Comprehensive income (loss) attributable to common shareholders	46,289	420	53,506	(40,876)

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

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**MERCER INTERNATIONAL INC.**  
**INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
**(In thousands of Euros)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 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	46,135	(14,112)	50,990	(64,938)
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities				
Loss (gain) on derivative instruments	(485)	3,327	10,523	10,889
Foreign exchange (gain) loss on debt	(9,927)	(3,779)	4,675	(4,533)
Loss (gain) on extinguishment of convertible notes			929	
Depreciation and amortization	14,055	13,447	42,052	40,518
Accretion expense (income)	1,111		2,056	
Noncontrolling interest	5,116	(1,937)	5,001	(11,195)
Deferred income taxes	(9,382)	(70)	(9,382)	(4,989)
Stock compensation expense	540	383	1,273	376
Pension and other post-retirement expense, net of funding	96	314	428	291
Inventory provisions				4,587
Other	989	777	2,836	(1,198)
Changes in current assets and liabilities				
Receivables	19,591	4,455	(26,351)	29,163
Inventories	(26,005)	2,398	(36,988)	29,923
Accounts payable and accrued expenses	1,814	1,695	15,146	9,635
Other	(4,883)	(1,597)	(5,477)	(963)
Net cash from (used in) operating activities	38,765	5,301	57,711	37,566
Cash flows from (used in) investing activities				
Purchase of property, plant and equipment	(8,484)	(3,994)	(28,876)	(19,535)
Proceeds on sale of property, plant and equipment	28	111	577	343
Cash, restricted		3,531		13,000
Notes receivable	216	333	711	574
Net cash from (used in) investing activities	(8,240)	(19)	(27,588)	(5,618)
Cash flows from (used in) financing activities				
Repayment of notes payable and debt	(6,211)	(18,249)	(14,477)	(26,499)
Repayment of capital lease obligations	(638)	(910)	(2,245)	(2,128)
Proceeds from borrowings of notes payable and debt		1,869	856	11,869

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Proceeds from (repayment of) credit facilities, net	(4,057)		1,493	(5,550)
Proceeds from government grants	6,778	546	17,337	546
Payment of deferred note issuance costs				(1,969)
Net cash from (used in) financing activities	(4,128)	(16,744)	2,964	(23,731)
Effect of exchange rate changes on cash and cash equivalents	(3,416)	637	748	606
Net increase (decrease) in cash and cash equivalents	22,981	(10,825)	33,835	8,823
Cash and cash equivalents, beginning of period	62,145	62,100	51,291	42,452
Cash and cash equivalents, end of period	85,126	51,275	85,126	51,275

*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>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 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	17,402	15,761	46,435	46,971
Income taxes	412	152	441	224
Schedule of non-cash investing and financing activities				
Acquisition of production and other equipment under capital lease obligations	429	153	959	269
Decrease (increase) in accounts payable relating to investing activities	7,000	2,464	1,283	1,323

*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 under the 2010 plan, 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 nine months ended September 30, 2010, potential stock based performance awards totaled 578,165, which potentially vest on December 31, 2010 (2009 565,165). Expense (income) recognized for the three and nine month periods ended September 30, 2010 was 483 and 1,190, respectively (2009 388 and 327).

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 September 30, 2010, no performance stock had vested (2009 nil). During the three and nine month period ended September 30, 2010, no performance stock were cancelled (2009 nil and 39,991).

*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 nine month periods ended September 30, 2010 was 60 and 83, respectively (2009 2 and 49).

In the second quarter, 56,000 restricted stock awards were granted to Directors of the Company (2009 nil) and 21,000 restricted stock awards vested in the three month period ended September 30, 2010. No restricted stock awards were granted in the third quarter of 2010 (2009 21,000) and there were no restricted stock awards cancelled during the three and nine month periods ended September 30, 2010 (2009 nil and nil). As at September 30, 2010, 56,000 restricted stock awards remain unvested.

As at September 30, 2010, the total remaining unrecognized compensation cost related to restricted stock amounted to approximately 148 (2009 9), which will be amortized over their remaining vesting periods.

*Stock Options*

During the three and nine month periods ended September 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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**MERCER INTERNATIONAL INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

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

**Note 3. Net Income (Loss) Per Share Attributable to Common Shareholders**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Net income (loss) attributable to common shareholders basic	46,135	(14,112)	50,990	(64,938)
Interest on convertible notes, net of tax	571		2,011	
Net income (loss) attributable to common shareholders diluted	46,706	(14,112)	53,001	(64,938)
Net income (loss) per share attributable to common shareholders				
Basic	1.17	(0.39)	1.36	(1.79)
Diluted	0.82	(0.39)	0.93	(1.79)
Weighted average number of common shares outstanding				
Basic <sup>(1)</sup>	39,446,447	36,306,027	37,383,444	36,293,489
Effect of dilutive instruments				
Performance rights	455,609		453,780	
Restricted stock	7,220		15,232	
Stock options and awards				
Convertible notes	17,113,010		19,167,690	
Diluted	57,022,286	36,306,027	57,020,146	36,293,489

(1) The basic weighted average number of shares excludes performance and restricted stock which have been issued, but have not vested as at September 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 nine month periods ended September 30, 2010 (2009 928,334).

Restricted stock excluded from the calculation of diluted income (loss) per share attributable to common shareholders because they were anti-dilutive represented 21,000 shares for the three and nine month periods ended September 30, 2009.

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

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

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**MERCER INTERNATIONAL INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

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

**Note 4. Inventories**

	<b>September 30, 2010</b>	<b>December 31, 2009</b>
Raw materials	48,313	24,888
Finished goods	37,629	24,198
Work in process and other	26,443	23,543
	112,385	72,629

**Note 5. Debt**

Debt consists of the following:

	<b>September 30, 2010</b>	<b>December 31, 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)	500,657	514,574
Senior notes due February 2013, interest at 9.25% accrued and payable semi-annually, unsecured (b)	227,924	216,299
Subordinated convertible notes due October 2010, interest at 8.5% accrued and payable semi-annually (c)	1,673	16,749
Subordinated convertible notes due January 2012, interest at 8.5% accrued and payable semi-annually (d)	33,129	26,160
Credit agreement with a lender with respect to a revolving credit facility of C\$40 million (e)	18,563	16,000
Loan payable to the noncontrolling shareholder of the Stendal mill (f)	30,925	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)	3,807	3,511
Credit agreement with a bank with respect to a revolving credit facility of 3,500 (i)		
	816,678	829,174
Less: current portion	(25,928)	(16,032)
Debt, less current portion	790,750	813,142

The Company made scheduled principal repayments under these facilities of 14,461 during the nine months ended September 30, 2010 (2009 26,500). As of September 30, 2010, the principal maturities of debt are as follows:

<b>Matures</b>	<b>Amount</b>
2010	1,673
2011	24,255
2012	58,800
2013 <sup>(1)</sup>	287,575
2014	40,543
Thereafter	403,832
	816,678

(1) Includes revolving credit facility principal amounts totalling 18,563.  
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**MERCER INTERNATIONAL INC.  
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

**(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 September 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 September 30, 2010 range from 2.04% to 2.72%), 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 455,657 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. As at September 30, 2010, the debt service reserve balance was approximately 6,968.

- (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 September 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 8.50% 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) and Note 12 Subsequent Events.
- (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 nine months ended September 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 8.50%, 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 three and nine months ended September 30, 2010, approximately \$18.1 million and \$18.2 million of Subordinated Convertible Notes due January 2012 were converted into 5,478,335 and 5,529,553 shares, respectively. The Company recorded a debt conversion expense of approximately \$0.8 million during the three months ended September 30, 2010 as a result of the conversions, which is included within interest expense in the Interim Consolidated Statements of Operations.

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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 September 30, 2010, this facility was accruing interest at a rate of approximately 4.95% and the undrawn amount was approximately C\$10.0 million.
- (f) Loans payable to the noncontrolling shareholder of the Stendal mill bear interest at 7.00%, 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 September 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 September 30, 2010, this facility was drawn by 3,807 and was accruing interest at a rate of 3.90%.
- (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 3.50% and are secured by certain land at our Rosenthal mill. As at September 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 gain of 485 and an unrealized loss of 10,523, respectively, with respect to these interest rate swaps for the three and nine months ended September 30, 2010 (2009 losses of 3,327 and 10,889), 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 63,396 (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 nine month periods ended September 30, 2010 totaled 280 and 677, respectively (2009 107 and 693).

The Company anticipates based on actuarial estimates that it will make contributions to the defined benefit pension plan of approximately 297 in 2010.

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**Note 7. Pension and Other Post-Retirement Benefit Obligations (continued)**

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 September 30,</b>		<b>2010</b>		<b>2009</b>	
	<b>Pension</b>	<b>Post-</b>	<b>Pension</b>	<b>Post-</b>	<b>Pension</b>	<b>Post-</b>
	<b>Benefits</b>	<b>Retirement</b>	<b>Benefits</b>	<b>Retirement</b>	<b>Benefits</b>	<b>Retirement</b>
		<b>Benefits</b>		<b>Benefits</b>		<b>Benefits</b>
Service cost	21	100	14	86		
Interest cost	425	196	382	205		
Expected return on plan assets	(398)		(321)			
Recognized net loss (gain)	111	(79)	36	(60)		
Net periodic benefit cost	159	217	111	231		

	<b>Nine Months Ended September 30,</b>		<b>2010</b>		<b>2009</b>	
	<b>Pension</b>	<b>Post-</b>	<b>Pension</b>	<b>Post-</b>	<b>Pension</b>	<b>Post-</b>
	<b>Benefits</b>	<b>Retirement</b>	<b>Benefits</b>	<b>Retirement</b>	<b>Benefits</b>	<b>Retirement</b>
		<b>Benefits</b>		<b>Benefits</b>		<b>Benefits</b>
Service cost	61	294	42	253		
Interest cost	1,257	580	1,129	606		
Expected return on plan assets	(1,175)		(949)			
Recognized net loss (gain)	329	(233)	105	(176)		
Net periodic benefit cost	472	641	327	683		

**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 nine months ended September 30, 2010, 5,529,553 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 September 30, 2010 and December 31, 2009, the Company had 42,029,660 and 36,443,487 common shares issued and outstanding, respectively.

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**Note 8. Share Capital (continued)***Preferred shares*

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 September 30, 2010, no preferred shares had been issued by the Company.

**Note 9. Financial Instruments**

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

	<b>September 30, 2010</b>		<b>December 31, 2009</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
Cash and cash equivalents	85,126	85,126	51,291	51,291
Investments	123	123	135	135
Receivables	101,920	101,920	71,143	71,143
Notes receivable	3,332	3,332	3,819	3,819
Accounts payable and accrued expenses	108,130	108,130	85,185	85,185
Debt	816,678	820,294	829,174	769,207
Interest rate derivative contracts liability	63,396	63,396	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 September 30, 2010 using:**

Description	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
<b>Assets</b>				
Investments (a)	123			123
<b>Liabilities</b>				
Derivatives (b)				
- Interest rate swaps		63,396		63,396

(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 September 30, 2010, the value of the project remaining to be completed is approximately 1,100 (C\$1.5 million), a majority of which is due to be paid within the next year. Pursuant to a contribution agreement finalized in November 2009, the Canadian Federal Government's Pulp and Paper Green Transformation Program (the Program) will provide approximately C\$40.7 million to complete the Green Energy Project, of which approximately 3,300 (C\$4.7 million) was receivable as at September 30, 2010. The Company is also eligible for an additional C\$17.0 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.

**Note 12. Subsequent Events**

On October 15, 2010, the Company repaid approximately \$2.3 million of the principal outstanding balance for the Subordinated Convertibles Notes due October 2010, and any unpaid interest up to the redemption date.

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**Note 13. 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 nine months ended September 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 Sheets**

	<b>September 30, 2010</b>			
	<b>Restricted Group</b>	<b>Unrestricted Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated Group</b>
<b>ASSETS</b>				
Current assets				
Cash and cash equivalents	48,411	36,715		85,126
Receivables	51,792	50,128		101,920
Inventories	68,257	44,128		112,385
Prepaid expenses and other	6,479	5,507		11,986
Total current assets	174,939	136,478		311,417
Property, plant and equipment	363,758	487,978		851,736
Deferred note issuance and other	2,608	4,333		6,941
Deferred income tax	12,990			12,990
Due from unrestricted group	78,177		(78,177)	
Note receivable	1,723			1,723
Total assets	634,195	628,789	(78,177)	1,184,807
<b>LIABILITIES</b>				
Current liabilities				
Accounts payable and accrued expenses	64,669	43,461		108,130
Pension and other post-retirement benefit obligations	608			608
Debt	2,761	23,167		25,928
Total current liabilities	68,038	66,628		134,666
Debt	282,335	508,415		790,750
Due to restricted group		78,177	(78,177)	
Unrealized interest rate derivative losses		63,396		63,396
Pension and other post-retirement benefit obligations	19,581			19,581
Capital leases and other	6,616	3,942		10,558

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Total liabilities	376,570	720,558	(78,177)	1,018,951
<b>EQUITY</b>				
Total shareholders' equity (deficit)	257,625	(65,797)		191,828
Noncontrolling interest (deficit)		(25,972)		(25,972)
Total liabilities and equity	634,195	628,789	(78,177)	1,184,807

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**Note 13. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Balance Sheets**

	<b>December 31, 2009</b>			
	<b>Restricted Group</b>	<b>Unrestricted Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated 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 13. Restricted Group Supplemental Disclosure (continued)**  
**Combined Condensed Statements of Operations**

**Three Months Ended September 30, 2010**

	<b>Restricted Group</b>	<b>Unrestricted Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated Group</b>
Revenues				
Pulp	123,518	101,179		224,697
Energy	1,535	8,186		9,721
	125,053	109,365		234,418
Operating costs	91,528	70,765		162,293
Operating depreciation and amortization	7,514	6,473		13,987
Selling, general and administrative expenses and other	3,221	3,506		6,727
	102,263	80,744		183,007
Operating income (loss)	22,790	28,621		51,411
Other income (expense)				
Interest expense	(8,796)	(10,213)	1,189	(17,820)
Investment income (loss)	1,246	36	(1,189)	93
Foreign exchange gain (loss) on debt	9,927			9,927
Gain (loss) on derivative instruments		485		485
Total other income (expense)	2,377	(9,692)		(7,315)
Income (loss) before income taxes	25,167	18,929		44,096
Income tax benefit (provision)	8,849	(1,694)		7,155
Net income (loss)	34,016	17,235		51,251
Less: net (income) loss attributable to noncontrolling interest		(5,116)		(5,116)
Net income (loss) attributable to common shareholders	34,016	12,119		46,135

**Three Months Ended September 30, 2009**

	<b>Restricted Group</b>	<b>Unrestricted Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated Group</b>
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Revenues				
Pulp	79,213	66,644		145,857
Energy	3,201	7,173		10,374
	82,414	73,817		156,231
Operating costs	78,136	58,430		136,566
Operating depreciation and amortization	6,816	6,569		13,385
Selling, general and administrative expenses and other	4,048	2,725		6,773
	89,000	67,724		156,724
Operating income (loss)	(6,586)	6,093		(493)
Other income (expense)				
Interest expense	(6,546)	(10,674)	1,135	(16,085)
Investment income (loss)	1,112	43	(1,135)	20
Foreign exchange gain (loss) on debt	3,779			3,779
Gain (loss) on derivative instruments		(3,327)		(3,327)
Total other income (expense)	(1,655)	(13,958)		(15,613)
Income (loss) before income taxes	(8,241)	(7,865)		(16,106)
Income tax benefit (provision)	108	(51)		57
Net income (loss)	(8,133)	(7,916)		(16,049)
Less: net (income) loss attributable to noncontrolling interest		1,937		1,937
Net income (loss) attributable to common shareholders	(8,133)	(5,979)		(14,112)

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**Note 13. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Statements of Operations**

**Nine Months Ended September 30, 2010**

	<b>Restricted Group</b>	<b>Unrestricted Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated Group</b>
Revenues				
Pulp	354,775	269,336		624,111
Energy	8,750	22,033		30,783
	363,525	291,369		654,894
Operating costs	269,063	201,914		470,977
Operating depreciation and amortization	22,355	19,462		41,817
Selling, general and administrative expenses and other	14,792	9,985		24,777
	306,210	231,361		537,571
Operating income (loss)	57,315	60,008		117,323
Other income (expense)				
Interest expense	(24,073)	(30,593)	3,525	(51,141)
Investment income (loss)	3,770	59	(3,525)	304
Foreign exchange gain (loss) on debt	(4,675)			(4,675)
Gain (loss) on extinguishment of convertible notes	(929)			(929)
Gain (loss) on derivative instruments		(10,523)		(10,523)
Total other income (expense)	(25,907)	(41,057)		(66,964)
Income (loss) before income taxes	31,408	18,951		50,359
Income tax benefit (provision)	8,354	(2,722)		5,632
Net income (loss)	39,762	16,229		55,991
Less: net (income) loss attributable to noncontrolling interest		(5,001)		(5,001)
Net income (loss) attributable to common shareholders.	39,762	11,228		50,990

**Nine Months Ended September 30, 2009**

	<b>Restricted Group</b>	<b>Unrestricted Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated Group</b>
Revenues				
Pulp	230,672	191,740		422,412
Energy	11,162	21,113		32,275
	241,834	212,853		454,687
Operating costs	232,364	185,232		417,596
Operating depreciation and amortization	20,408	19,917		40,325
Selling, general and administrative expenses and other	10,665	8,743		19,408
	263,437	213,892		477,329
Operating income (loss)	(21,603)	(1,039)		(22,642)
Other income (expense)				
Interest expense	(20,775)	(31,543)	3,365	(48,953)
Investment income (loss)	3,262	(2,941)	(3,365)	(3,044)
Foreign exchange gain (loss) on debt	4,533			4,533
Gain (loss) on derivative instruments		(10,889)		(10,889)
Total other income (expense)	(12,980)	(45,373)		(58,353)
Income (loss) before income taxes	(34,583)	(46,412)		(80,995)
Income tax benefit (provision)	(833)	5,695		4,862
Net income (loss)	(35,416)	(40,717)		(76,133)
Less: net (income) loss attributable to noncontrolling interest		11,195		11,195
Net income (loss) attributable to common shareholders.	(35,416)	(29,522)		(64,938)

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**(Unaudited)**

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

**Note 13. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Statements of Cash Flows**

	<b>Three Months Ended September 30, 2010</b>		
	<b>Restricted Group</b>	<b>Unrestricted Group</b>	<b>Consolidated Group</b>
Cash flows from (used in) operating activities			
Net income (loss) attributable to common shareholders	34,016	12,119	46,135
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities			
Loss (gain) on derivative instruments		(485)	(485)
Foreign exchange loss (gain) on debt	(9,927)		(9,927)
Depreciation and amortization	7,582	6,473	14,055
Accretion expense (income)	1,111		1,111
Noncontrolling interest		5,116	5,116
Deferred income taxes	(9,382)		(9,382)
Stock compensation expense	540		540
Pension and other post-retirement expense, net of funding	96		96
Other	286	703	989
Changes in current assets and liabilities			
Receivables	13,790	5,801	19,591
Inventories	(13,209)	(12,796)	(26,005)
Accounts payable and accrued expenses	(2,127)	3,941	1,814
Other <sup>(1)</sup>	(4,242)	(641)	(4,883)
Net cash from (used in) operating activities	18,534	20,231	38,765
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(8,392)	(92)	(8,484)
Proceeds on sale of property, plant and equipment	27	1	28
Notes receivable	216		216
Net cash from (used in) investing activities	(8,149)	(91)	(8,240)
Cash flows from (used in) financing activities			
Repayment of notes payable and debt	(544)	(5,667)	(6,211)
Repayment of capital lease obligations	(220)	(418)	(638)
Proceeds from (repayment of) credit facilities, net	(4,057)		(4,057)
Proceeds from government grants	6,778		6,778
Net cash from (used in) financing activities	1,957	(6,085)	(4,128)

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Effect of exchange rate changes on cash and cash equivalents	(3,416)		(3,416)
Net increase (decrease) in cash and cash equivalents	8,926	14,055	22,981
Cash and cash equivalents, beginning of period	39,485	22,660	62,145
Cash and cash equivalents, end of period	48,411	36,715	85,126

(1) Includes intercompany working capital related transactions.

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**Note 13. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Statements of Cash Flows**

	<b>Three Months Ended September 30, 2009</b>		
	<b>Restricted Group</b>	<b>Unrestricted Group</b>	<b>Consolidated Group</b>
Cash flows from (used in) operating activities			
Net income (loss) attributable to common shareholders	(8,133)	(5,979)	(14,112)
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities			
Loss (gain) on derivative instruments		3,327	3,327
Foreign exchange loss (gain) on debt	(3,779)		(3,779)
Depreciation and amortization	6,878	6,569	13,447
Noncontrolling interest		(1,937)	(1,937)
Deferred income taxes	(71)	1	(70)
Stock compensation expense	383		383
Pension and other post-retirement expense, net of funding	314		314
Other	158	619	777
Changes in current assets and liabilities			
Receivables	5,229	(774)	4,455
Inventories	(1,630)	4,028	2,398
Accounts payable and accrued expenses	5,437	(3,742)	1,695
Other <sup>(1)</sup>	(2,764)	1,167	(1,597)
Net cash from (used in) operating activities	2,022	3,279	5,301
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(3,785)	(209)	(3,994)
Proceeds on sale of property, plant and equipment	9	102	111
Cash, restricted		3,531	3,531
Note receivable	333		333
Net cash from (used in) investing activities	(3,443)	3,424	(19)
Cash flows from (used in) financing activities			
Repayment of notes payable and debt	(10,000)	(8,249)	(18,249)
Repayment of capital lease obligations	(179)	(731)	(910)
Proceeds from borrowing of notes payable and debt	1,869		1,869
Proceeds from government grants	546		546
Net cash from (used in) financing activities	(7,764)	(8,980)	(16,744)



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Effect of exchange rate changes on cash and cash equivalents	637		637
Net increase (decrease) in cash and cash equivalents	(8,548)	(2,277)	(10,825)
Cash and cash equivalents, beginning of period	33,842	28,258	62,100
Cash and cash equivalents, end of period	25,294	25,981	51,275

(1) Includes intercompany working capital related transactions.

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

**Note 13. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Statements of Cash Flows**

	<b>Nine Months Ended September 30, 2010</b>		
	<b>Restricted Group</b>	<b>Unrestricted Group</b>	<b>Consolidated Group</b>
Cash flows from (used in) operating activities			
Net income (loss) attributable to common shareholders	39,762	11,228	50,990
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities			
Loss (gain) on derivative instruments		10,523	10,523
Foreign exchange loss (gain) on debt	4,675		4,675
Gain (loss) on extinguishment of convertible notes	929		929
Depreciation and amortization	22,590	19,462	42,052
Accretion (income) expense	2,056		2,056
Noncontrolling interest		5,001	5,001
Deferred income taxes	(9,382)		(9,382)
Stock compensation expense	1,273		1,273
Pension and other post-retirement expense, net of funding	428		428
Other	856	1,980	2,836
Changes in current assets and liabilities			
Receivables	(12,778)	(13,573)	(26,351)
Inventories	(12,592)	(24,396)	(36,988)
Accounts payable and accrued expenses	5,595	9,551	15,146
Other <sup>(1)</sup>	(8,040)	2,563	(5,477)
Net cash from (used in) operating activities	35,372	22,339	57,711
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(27,467)	(1,409)	(28,876)
Proceeds on sale of property, plant and equipment	90	487	577
Cash, restricted			
Note receivable	711		711
Net cash from (used in) investing activities	(26,666)	(922)	(27,588)
Cash flows from (used in) financing activities			
Repayment of notes payable and debt	(560)	(13,917)	(14,477)
Repayment of capital lease obligations	(804)	(1,441)	(2,245)
Proceeds from borrowings of notes payable and debt	856		856
Proceeds from (repayment of) credit facilities, net	1,493		1,493
Proceeds from government grants	17,337		17,337

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Net cash from (used in) financing activities	18,322	(15,358)	2,964
Effect of exchange rate changes on cash and cash equivalents	748		748
Net increase (decrease) in cash and cash equivalents	27,776	6,059	33,835
Cash and cash equivalents, beginning of period	20,635	30,656	51,291
Cash and cash equivalents, end of period	48,411	36,715	85,126

(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 13. Restricted Group Supplemental Disclosure (continued)****Combined Condensed Statements of Cash Flows**

	<b>Nine Months Ended September 30, 2009</b>		
	<b>Restricted Group</b>	<b>Unrestricted Group</b>	<b>Consolidated Group</b>
Cash flows from (used in) operating activities			
Net income (loss) attributable to common shareholders	(35,416)	(29,522)	(64,938)
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities			
Loss (gain) on derivative instruments		10,889	10,889
Foreign exchange loss (gain) on debt	(4,533)		(4,533)
Depreciation and amortization	20,601	19,917	40,518
Noncontrolling interest		(11,195)	(11,195)
Deferred income taxes	838	(5,827)	(4,989)
Stock compensation expense	376		376
Pension and other post-retirement expense, net of funding	291		291
Inventory provisions	3,233	1,354	4,587
Other	507	(1,705)	(1,198)
Changes in current assets and liabilities			
Receivables	27,444	1,719	29,163
Inventories	9,684	20,239	29,923
Accounts payable and accrued expenses	11,960	(2,325)	9,635
Other <sup>(1)</sup>	(15,227)	14,264	(963)
Net cash from (used in) operating activities	19,758	17,808	37,566
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(18,312)	(1,223)	(19,535)
Proceeds on sale of property, plant and equipment	107	236	343
Cash, restricted		13,000	13,000
Note receivable	574		574
Net cash from (used in) investing activities	(17,631)	12,013	(5,618)
Cash flows from (used in) financing activities			
Repayment of notes payable and debt	(10,000)	(16,499)	(26,499)
Repayment of capital lease obligations	(480)	(1,648)	(2,128)
Proceeds from borrowings of notes payables and debt	11,869		11,869
Proceeds from (repayment of) credit facilities, net	(5,550)		(5,550)
Proceeds from government grants	546		546
Payment of deferred note issuance costs		(1,969)	(1,969)

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Net cash from (used in) financing activities	(3,615)	(20,116)	(23,731)
Effect of exchange rate changes on cash and cash equivalents	606		606
Net increase (decrease) in cash and cash equivalents	(882)	9,705	8,823
Cash and cash equivalents, beginning of period	26,176	16,276	42,452
Cash and cash equivalents, end of period	25,294	25,981	51,275

(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 September 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-dried 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 nine months ended September 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***

Pulp prices were generally stable in the third quarter of 2010 after reaching record levels in the second quarter of 2010. As we move into the fourth quarter of 2010, there has been some softness in NBSK pulp pricing that we believe has resulted from the start up of a previously closed mill and increased hardwood capacity. However, we expect that demand/supply conditions, including prospects for improving Chinese demand and relatively low NBSK pulp inventory levels, should result in a reasonably favorable outlook for our business.

The completion of the Celgar Energy Project at the end of September 2010 should also provide us with a new stable revenue source unrelated to pulp pricing.

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**Table of Contents****Third Quarter and Nine Months Operational Snapshot**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Pulp Production ( 000 ADMTs)	380.9	345.8	1,070.0	1,040.6
Scheduled Production Downtime ( 000 ADMTs)	8.3	35.4	43.5	38.1
Pulp Sales ( 000 ADMTs)	344.8	361.6	1,042.6	1,093.7
Pulp Revenues (in millions)	224.7	145.9	624.1	422.4
NBSK pulp list prices in Europe (\$/ADMT)	\$ 980	\$ 693	\$ 932	\$ 627
NBSK pulp list prices in Europe ( /ADMT)	758	485	708	459
Average pulp sales realizations ( /ADMT <sup>(1)</sup> )	642	397	590	380
Energy Production ( 000 MWh)	330.8	354.4	1,051.1	1,086.7
Energy Sales ( 000 MWh)	119.1	121.8	370.3	362.6
Energy Revenue (in millions)	9.7	10.4	30.8	32.3
Average energy sales realizations ( /MWh)	82	85	83	89
Average Spot Currency Exchange Rates				
/(\$)	0.7729	0.6989	0.7608	0.7337
C\$/ \$( <sup>2</sup> )	1.0385	1.0972	1.0358	1.1700
C\$/ ( <sup>3</sup> )	1.3438	1.5694	1.3639	1.5934

(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 September 30, 2010 Compared to Three Months Ended September 30, 2009**

Pulp revenues for the three months ended September 30, 2010 increased by approximately 54% to 224.7 million from 145.9 million in the comparative quarter of 2009, due to significantly higher pulp prices and a stronger U.S. dollar relative to the Euro. Revenues from the sale of excess energy decreased slightly to 9.7 million in the third quarter from 10.4 million in the same quarter last year, primarily due to our Rosenthal mill's scheduled turbine maintenance. During the current quarter, the Rosenthal mill had nine days of downtime for scheduled maintenance and its turbine was down for an additional 51 days of maintenance. During this 51-day period, the Rosenthal mill produced pulp at capacity but purchased energy instead of selling surplus energy.

Pulp prices in the third 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 \$980 ( 758) per ADMT in the current quarter compared to approximately \$693 ( 485) per ADMT in the third quarter of 2009 and \$800 ( 558) at the end of 2009. In the third quarter of 2010, average pulp sales realizations increased by approximately 62% to 642 per ADMT from 397 per ADMT in the same period last year, primarily due to significantly higher pulp prices and a stronger U.S. dollar relative to the Euro.

Pulp sales volume decreased to 344,777 ADMTs in the current quarter from 361,627 ADMTs in the comparative period of 2009, primarily due to certain orders slipping into the fourth quarter of 2010.





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Pulp production increased to 380,894 ADMTs in the current quarter from 345,833 ADMTs in the same quarter of 2009, primarily due to record levels of production at our Celgar and Stendal mills, partially offset by nine days (approximately 8,000 ADMTs) of scheduled maintenance downtime at our Rosenthal mill. In the comparative quarter of 2009, we had 30 days (approximately 35,000 ADMTs) of scheduled maintenance downtime at our German mills. Costs and expenses in the third quarter of 2010 increased to 183.0 million from 156.7 million in the comparative period of 2009, primarily due to higher fiber costs and higher energy costs resulting from the turbine maintenance at the Rosenthal mill.

In the third quarter of 2010, operating depreciation and amortization increased slightly to 14.0 million from 13.4 million in the same quarter last year. Selling, general and administrative expenses increased slightly to 6.9 million from 6.6 million in the third quarter of 2009, primarily as a result of a stronger Euro.

Transportation costs increased to 16.3 million in the third quarter of 2010 from 14.2 million in the third quarter of 2009, primarily due to higher container rates.

On average, our per unit fiber costs in the current quarter increased by approximately 32% from the same period in 2009, primarily due to higher fiber costs at our German mills, which increased due to stronger demand for fiber from the European board industry, and continuing weak lumber markets which resulted in low timber harvesting rates and reduced availability of wood residuals in Germany.

For the third quarter of 2010, we recorded operating income of 51.4 million compared to an operating loss of 0.5 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 third quarter of 2010 increased marginally to 17.8 million from 16.1 million in the comparative quarter of 2009, due to the accretion expense related to the exchange of our convertible notes, which was partially offset by reduced levels of debt associated with the Stendal mill.

Our Stendal mill recorded an unrealized gain of 0.5 million on the mark to market of its interest rate derivatives in the current quarter, compared to an unrealized loss of 3.3 million in the same quarter of last year. We recorded a foreign exchange gain of 9.9 million on our foreign currency denominated debt compared to a foreign exchange gain of 3.8 million in the same period of 2009.

During the current quarter, we recorded 7.2 million of net income tax recoveries, compared to a nominal net tax recovery of 0.1 million in the same period last year. The tax recoveries reflect our expectation that certain of our tax assets will be utilized to reduce taxable income in the future.

In the third quarter of 2010, the noncontrolling shareholder's interest in the Stendal mill's income was 5.1 million, compared to a loss of 1.9 million in the same quarter last year.

We reported net income attributable to common shareholders for the third quarter of 2010 of 46.1 million, or 1.17 per basic and 0.82 per diluted share, which included aggregate non-cash, unrealized gains of 10.4 million, or 0.26 per basic share, on the Stendal interest rate derivatives and the foreign exchange effect on our debt. In the third quarter of 2009, the net loss attributable to common shareholders was 14.1 million, or 0.39 per basic and diluted share, which included a net non-cash unrealized gain of 0.5 million on the Stendal interest rate derivatives and the foreign exchange effect on our debt.

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Operating EBITDA in the third quarter of 2010 increased to 65.5 million (\$84.7 million) from 62.1 million (\$79.1 million) in the prior quarter and 13.0 million (\$18.6 million) in the third 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>September 30,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(in thousands)</b>	
Net income (loss) attributable to common shareholders	46,135	(14,112)
Net income (loss) attributable to noncontrolling interest	5,116	(1,937)
Income taxes (benefits)	(7,155)	(57)
Interest expense	17,820	16,085
Investment (income) loss	(93)	(20)
Foreign exchange (gain) loss on debt	(9,927)	(3,779)
Loss (gain) on derivative instruments	(485)	3,327
Operating income (loss)	51,411	(493)
Add: Depreciation and amortization	14,055	13,447
Operating EBITDA	65,466	12,954

***Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2009***

Pulp revenues for the nine months ended September 30, 2010 increased by approximately 48% to 624.1 million from 422.4 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 decreased slightly to 30.8 million from 32.3 million in the comparative period last year, primarily due to scheduled turbine maintenance at our Rosenthal mill. Pulp prices in the first nine months 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 \$932 ( 708) per ADMT in the first nine months of 2010 compared to approximately \$627 ( 459) per ADMT in the first nine months of 2009. In the first nine months of 2010, average pulp sales realizations increased by approximately 55% to 590 per ADMT from 380 per ADMT in the same period last year, primarily due to significantly higher pulp prices. Pulp sales volume decreased slightly to 1,042,649 ADMTs in the first nine months of 2010 from 1,093,664 ADMTs in the comparative period of 2009.

Pulp production increased to 1,070,043 ADMTs in the first nine months of 2010 from 1,040,582 ADMTs in the comparative period of 2009, primarily due to the near record production of all our mills in 2010. We had 31 days of scheduled maintenance downtime and resulting production curtailments of approximately 43,000 ADMTs in the first nine months of 2010, compared to an aggregate of 33 days of maintenance downtime and resulting production curtailments of approximately 38,000 ADMTs in the same period of 2009.

Costs and expenses in the first nine months of 2010 increased to 537.6 million from 477.3 million in the comparative period of 2009, primarily due to higher fiber costs in Germany and annual and turbine maintenance costs at our mills. In the nine months ended September 30, 2010, operating depreciation and amortization increased slightly to 41.8 million from 40.3 million in the same period last year. Selling, general and administrative expenses increased in the first nine months of 2010 to 24.9 million from 19.8 million in the comparative period of 2009, primarily as a result of increased selling costs and a stronger Canadian dollar relative to the Euro.

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Transportation costs increased to 47.6 million in the first nine months of 2010 from 43.1 million in the first nine months of 2009, primarily due to higher container rates.

Overall, our per unit fiber costs increased by approximately 23% in the first nine months 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 and continuing weak lumber markets which resulted in low timber harvesting rates and reduced availability of wood residuals.

For the first nine months of 2010, we recorded operating income of 117.3 million compared to an operating loss of 22.6 million in the comparative period of 2009, primarily due to significantly higher pulp price realizations.

Interest expense in the first nine months of 2010 increased marginally to 51.1 million from 49.0 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 10.5 million on the mark to market of its interest rate derivatives at the period ended September 30, 2010, compared to an unrealized loss of 10.9 million in the comparative period.

In the first nine months of 2010, we recorded a foreign exchange loss of 4.7 million on our foreign currency denominated debt compared to a gain of 4.5 million in the same period of 2009.

In the first nine months 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.

During the first nine months of 2010, we recorded 5.6 million of net income tax recoveries, compared to 4.9 million in the same period of 2009. The tax recoveries reflect our expectation that certain of our tax assets will be utilized to reduce taxable income in the future.

In the first nine months of 2010, the noncontrolling shareholder's interest in the Stendal mill's income was 5.0 million, compared to a loss of 11.2 million in the same period last year.

We reported net income attributable to common shareholders for the first nine months of 2010 of 51.0 million, or 1.36 per basic and 0.93 per diluted share, which included aggregate non-cash, unrealized losses of 15.2 million on the Stendal interest derivatives and the foreign exchange effect on our debt. In the first nine months of 2009, the net loss attributable to common shareholders was 64.9 million, or 1.79 per basic and diluted share, which included a net non-cash unrealized loss of 6.4 million on the Stendal interest rate derivatives and the foreign exchange effect on our debt.

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Operating EBITDA increased significantly to 159.4 million in the first nine months of 2010 compared to Operating EBITDA of 17.9 million in the nine months ended September 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 September 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>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(in thousands)</b>	
Net income (loss) attributable to common shareholders	50,990	(64,938)
Net income (loss) attributable to noncontrolling interest	5,001	(11,195)
Income taxes (benefits)	(5,632)	(4,862)
Interest expense	51,141	48,953
Investment (income) loss	(304)	3,044
Foreign exchange loss (gain) on debt	4,675	(4,533)
Loss (gain) on extinguishment of convertible notes	929	
Loss (gain) on derivative instruments	10,523	10,889
Operating income (loss)	117,323	(22,642)
Add: Depreciation and amortization	42,052	40,518
Operating EBITDA	159,375	17,876

**Liquidity and Capital Resources**

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

	<b>September</b>	<b>December 31,</b>
	<b>30,</b>	<b>2009</b>
	<b>2010</b>	<b>2009</b>
	<b>(in thousands)</b>	
<b>Financial Position</b>		
Cash and cash equivalents	85,126	51,291
Receivables	101,920	71,143
Inventories	112,385	72,629
Prepaid expenses and other	11,986	5,871
Total current assets	311,417	200,934
Total current liabilities	134,666	101,784
Working capital	176,751	99,150
Property, plant and equipment	851,736	868,558
Total assets	1,184,807	1,083,831
Long-term liabilities	884,285	896,074
Total equity	165,856	85,973

As at September 30, 2010, our cash and cash equivalents and working capital had increased to 176.8 million, respectively, from 51.3 million and 99.2 million, respectively, at the end of 2009.

**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.

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In the last quarter of 2009, our Celgar mill was allocated approximately C\$57.7 million under the Government of Canada's Green Transformation Program or GTP, of which approximately C\$40.7 million in grants was allocated to costs associated with the Celgar Energy Project. We expect to utilize approximately C\$7.0 million of the balance for enhancements and the increased scope we implemented for the Celgar Energy Project and the remainder for other qualifying projects through March 2012. In December 2009, we received an initial grant of C\$12.9 million from Natural Resources Canada, or NRCan, and additional grants of C\$23.1 million (17.3 million) during the first nine months of 2010. At September 30, 2010, our Celgar mill had approximately C\$4.7 million of grant monies related to holdbacks that we expect to receive in early 2011 and approximately C\$1.5 million (1.1 million) of remaining costs to be reimbursed through the GTP.

Capital expenditures related to the Celgar Energy Project totaled approximately 13.1 million in 2009 and 26.3 million in 2010 substantially all of which was financed through grants from the Canadian federal government under the GTP.

***Debt Covenants***

Our long-term obligations contain various financial tests and covenants customary to these types of arrangements. As at September 30, 2010, we were in 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.

Cash provided by operating activities increased to 57.7 million in the nine months ended September 30, 2010 from 37.6 million in the same period of 2009, primarily due to improved operating results, offset in significant part by working capital movements. An increase in receivables used cash of 26.4 million in the first nine months of 2010, compared to a decrease in receivables providing cash of 29.2 million in the first nine months of 2009. An increase in inventories used cash of 37.0 million in the first nine months of 2010, compared to a decrease in inventories before non-cash provisions providing cash of 29.9 million in the first nine months of 2009. An increase in accounts payable and accrued expenses provided cash of 15.1 million in the first nine months of 2010, compared to an increase in accounts payable and accrued expenses providing cash of 9.6 million in the first nine months of 2009.

***Cash Flows from Investing Activities.*** Investing activities in the first nine months of 2010 used cash of 27.6 million, compared to using cash of 5.6 million in the same period of 2009. Capital expenditures in the first nine months of 2010 used cash of 28.9 million primarily for the Celgar Energy Project, compared to 19.5 million in the same period of 2009.

***Cash Flows from Financing Activities.*** In the first nine months of 2010, financing activities provided cash of 3.0 million, compared to using cash of 23.7 million in the same period last year, primarily as a result of the receipt of government grants of 16.2 million for the Celgar Energy Project in 2010. Repayment of indebtedness used cash of 14.5 million and 26.5 million in the nine months ended September 30, 2010 and 2009, respectively. Proceeds from credit facilities provided cash of 1.5 million and used cash of 5.6 million in the nine months ended September 30, 2010 and 2009, respectively.

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***Capital Resources***

Other than commitments totaling approximately 1.1 million relating to the Celgar Energy Project, we have no material commitments to acquire assets or operating businesses.

***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 material contractual obligations during the first nine months 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 nine months ended September 30, 2010, accumulated other comprehensive income increased by 2.5 million to 26.2 million, primarily due to the foreign exchange translation.

Based upon the exchange rate at September 30, 2010, the U.S. dollar strengthened by approximately 8% in value against the Euro since September 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 13 of our interim consolidated financial statements included herein.

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

Pulp revenues for the Restricted Group for the three months ended September 30, 2010 significantly increased by approximately 56% to 123.5 million from 79.2 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 decreased by approximately 53% in the current quarter to 1.5 million from 3.2 million in the same period last year, primarily due to approximately 60 days of scheduled turbine maintenance at our Rosenthal mill in 2010.

Pulp prices were significantly higher in the third 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 \$980 ( 758) per ADMT in the current quarter compared to approximately \$693 ( 485) per ADMT in the third quarter of 2009. In the third quarter of 2010, average pulp sales realizations for the Restricted Group increased by approximately 60% to 643 per ADMT from 402 per ADMT in the same period last year.

Pulp sales volume of the Restricted Group decreased marginally to 191,860 ADMTs in the third quarter of 2010 from 197,007 ADMTs in the comparative period of 2009, primarily due to certain orders slipping into the fourth quarter of 2010.

Pulp production for the Restricted Group increased to 207,720 ADMTs in the third quarter of 2010 from 192,173 ADMTs in the same period of 2009, primarily as a result of improved mill reliability and only nine days (approximately 8,000 tonnes) of scheduled maintenance downtime at our Rosenthal mill in 2010, compared to 21 days (approximately 20,000 tonnes) in 2009.

Costs and expenses for the Restricted Group in the third quarter of 2010 increased to 102.3 million from 89.0 million in the comparative period of 2009, primarily due to higher fiber costs and higher energy costs resulting from the turbine maintenance at the Rosenthal mill.

In the third quarter of 2010, operating depreciation and amortization for the Restricted Group increased to 7.5 million from 6.8 million in the same period last year. Selling, general and administrative expenses and other for the Restricted Group decreased to 3.2 million from 4.0 million in the comparative period of 2009, primarily as a result of a stronger Euro.

Transportation costs for the Restricted Group increased to 12.3 million in the third quarter of 2010 from 9.7 million in the same period of 2009, primarily due to higher container rates.

Overall, per unit fiber costs of the Restricted Group in the third quarter of 2010 increased by approximately 21% compared to the same period of 2009, primarily due to increased German fiber prices resulting from increased demand from the European board industry and continuing weak lumber markets which resulted in low timber harvesting rates and reduced availability of wood residuals.

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In the third quarter of 2010, the Restricted Group reported operating income of \$22.8 million compared to an operating loss of \$6.6 million in the third quarter of 2009, primarily due to significantly higher pulp realizations.

Interest expense for the Restricted Group increased to \$8.8 million in the third quarter from \$6.5 million in the same quarter last year, primarily due to the accretion expense related to the exchange of our convertible notes in January 2010.

In the third quarter of 2010, the Restricted Group recorded a gain on foreign currency denominated debt of \$9.9 million, compared to a gain of \$3.8 million in the comparative quarter of 2009.

During the third quarter of 2010, the Restricted Group recorded \$8.8 million of net income tax recoveries, compared to \$0.1 million in the same period last year. The tax recoveries reflect our expectation that certain of our tax assets will be utilized to reduce taxable income in the future.

The Restricted Group reported net income for the third quarter of 2010 of \$34.0 million compared to a net loss of \$8.1 million in the same period last year.

In the third quarter of 2010, the Restricted Group reported Operating EBITDA of \$30.4 million compared to Operating EBITDA of \$0.3 million in the comparative quarter of 2009 and Operating EBITDA of \$26.2 million in the second 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 September 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</b>	
	<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(in thousands)</b>	
<b>Restricted Group<sup>(1)</sup></b>		
Net income (loss)	34,016	(8,133)
Income taxes (benefits)	(8,849)	(108)
Interest expense	8,796	6,546
Investment (income) loss	(1,246)	(1,112)
Foreign exchange loss (gain) on debt	(9,927)	(3,779)
Operating income (loss)	22,790	(6,586)
Add: Depreciation and amortization.	7,582	6,878
Operating EBITDA	30,372	292

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

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***Restricted Group Results Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2009***

Pulp revenues for the Restricted Group for the nine months ended September 30, 2010 increased by approximately 54% to 354.8 million from 230.7 million in the comparative period of 2009, primarily due to significantly higher pulp prices. Revenues from the sale of excess energy decreased by approximately 21% in the first nine months of 2010 to 8.8 million from 11.2 million in the same period last year, primarily due to approximately 60 days of scheduled turbine maintenance at our Rosenthal mill in 2010. During the third quarter of 2010, the Rosenthal mill had nine days of downtime for scheduled maintenance and its turbine was down for an additional 51 days for maintenance. During such 51-day period, the Rosenthal mill produced pulp at capacity but purchased energy instead of selling surplus energy.

Pulp prices were significantly higher in the first nine months of 2010 than in the same period last year due to continued strengthening in global pulp markets. Average list prices for NBSK pulp in Europe were approximately \$932 ( 708) per ADMT in the first nine months of 2010 compared to approximately \$627 ( 459) per ADMT in the first nine months of 2009. In the first nine months of 2010, average pulp sales realizations for the Restricted Group increased by approximately 53% to 591 per ADMT from 387 per ADMT in the same period last year.

Pulp sales volume of the Restricted Group increased to 599,971 ADMTs in the first nine months of 2010 from 594,787 ADMTs in the comparative period of 2009.

Pulp production for the Restricted Group increased to 611,753 ADMTs in the first nine months of 2010 from 579,785 ADMTs in the same period of 2009, primarily as a result of improved mill reliability. In the first nine months of 2010, our Celgar and Rosenthal mills had an aggregate of 21 days (approximately 25,000 ADMTs) of scheduled maintenance downtime, compared to 24 days (approximately 23,000 ADMTs) of maintenance downtime in the first nine months of 2009.

Costs and expenses for the Restricted Group in the first nine months of 2010 increased to 306.2 million from 263.4 million in the comparative period of 2009, primarily due to higher fiber costs in Germany and higher energy costs resulting from the turbine maintenance at the Rosenthal mill.

In the first nine months of 2010, operating depreciation and amortization for the Restricted Group increased to 22.4 million from 20.4 million in the same period last year. Selling, general and administrative expenses and other increased to 14.8 million from 10.7 million in the comparative period of 2009, primarily as a result of increased selling costs and a stronger Canadian dollar relative to the Euro.

Transportation costs for the Restricted Group increased to 36.1 million in the first nine months of 2010 from 29.7 million in the first nine months of 2009, primarily due to higher shipments and container rates.

Overall, per unit fiber costs of the Restricted Group increased by approximately 16% in the first nine months of 2010 compared to the same period of 2009, primarily due to increased German fiber prices resulting from increased demand from the European board industry and continuing weak lumber markets which resulted in low harvesting rates and reduced availability of wood residuals.

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In the first nine months of 2010, the Restricted Group reported operating income of \$57.3 million compared to an operating loss of \$21.6 million in the first nine months of 2009, primarily due to significantly higher pulp realizations. Interest expense for the Restricted Group increased to \$24.1 million in the first nine months of 2010 from \$20.8 million in the first nine months of 2009, primarily due to the accretion expense related to the exchange of our convertible notes.

Most of the long-term debt of the Restricted Group is denominated and repayable in foreign currencies, principally U.S. dollars. In the first nine months of 2010, the Restricted Group recorded a non-cash loss on foreign currency denominated debt of \$4.7 million as a result of the strengthening of the U.S. dollar during the first half of 2010, compared to a gain of \$4.5 million in the comparative period of 2009.

During the first nine months of 2010, in connection with the exchange of a portion of our convertible notes, the Restricted Group recorded a loss of approximately \$0.9 million on the extinguishment of the 2010 Convertible Notes. During the first nine months of 2010, the Restricted Group recorded \$8.3 million of net income tax recoveries, compared to an income tax provision of \$0.8 million in the comparative period of 2009. The tax recoveries reflect our expectation that certain of our tax assets will be utilized to reduce taxable income in the future.

The Restricted Group reported net income for the first nine months of 2010 of \$39.8 million compared to a net loss of \$35.4 million in the first nine months of 2009.

In the first nine months of 2010, the Restricted Group reported Operating EBITDA of \$79.9 million compared to an Operating EBITDA loss of \$1.0 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 September 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>Nine Months Ended September 30, 2010                  2009 (in thousands)</b>	
<b>Restricted Group<sup>(1)</sup></b>		
Net income (loss)	39,762	(35,416)
Income taxes (benefits)	(8,354)	833
Interest expense	24,073	20,775
Investment (income) loss	(3,770)	(3,262)
Foreign exchange (gain) loss on debt	4,675	(4,533)
Loss (gain) on extinguishment of convertible notes	929	
Operating income (loss)	57,315	(21,603)
Add: Depreciation and amortization	22,590	20,601
Operating EBITDA	79,905	(1,002)

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

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**Table of Contents****Liquidity and Capital Resources of the Restricted Group**

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

	<b>September 30, 2010</b>	<b>December 31, 2009</b>
	<b>(in thousands)</b>	
<b>Restricted Group Financial Position<sup>(1)</sup></b>		
Cash and cash equivalents	48,411	20,635
Receivables	51,792	34,588
Inventories	68,257	52,897
Prepaid expenses and other	6,479	3,452
Total current assets	174,939	111,572
Total current liabilities	68,038	54,557
Working capital	106,901	57,015
Property, plant and equipment	363,758	362,311
Total assets	634,195	555,977
Long-term liabilities	308,532	301,173
Total equity	257,625	200,247

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

At September 30, 2010, cash and cash equivalents and working capital for the Restricted Group had increased to 48.4 million and 106.9 million, respectively, from 20.6 million and 57.0 million, respectively, at the end of 2009. 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.

*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 to B from 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 reflected the expectation that we would 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.

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**Critical Accounting Policies**

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect both the amount and the timing of the recording of assets, liabilities, revenues, and expenses in the consolidated financial statements and accompanying note 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.

**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.

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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.

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. European list pulp prices remained generally stable around \$980 per ADMT throughout the third quarter of 2010.

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.

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*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. The state of lumber markets affects both the amount of wood residuals, such as chips, produced as a by-product of lumber and the level of timber harvesting, which provides us with pulp logs. Production costs also depend on the total volume of production. Lower operating rates 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 nine months of 2010, we recorded an unrealized loss of \$10.5 million on our outstanding interest rate derivatives compared to an unrealized loss of \$10.9 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.

In September of 2010, the Celgar mill received a letter from the Upper Columbia River Natural Resources Trustee Council, an organization consisting of aboriginal groups and US government representatives (the Council), alleging that, based on their preliminary assessment (the Preliminary Assessment), between 1961 to 1993, the Celgar mill had discharged chlorinated organic compounds into the Columbia River. The Preliminary Assessment was conducted to evaluate the need to conduct a formal natural resource damage assessment under the U.S. *Comprehensive Environmental Response, Compensation and Liability Act* ( CERCLA ). Although we did not acquire the Celgar mill until 2005, and the Celgar mill's alleged discharge occurred prior to our acquisition of the mill, the Council determined to proceed with a formal natural resource damage assessment under the CERCLA. Although at this time it is unclear as to whether any harm was caused by these alleged discharges and, in any event, we do not believe we are liable, due to the preliminary nature of the assessment, we cannot at this time quantify the costs, if any, associated with this matter.

**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.

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**ITEM 6. EXHIBITS**

**Exhibit**

<b>No.</b>	<b>Description</b>
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: November 4, 2010  
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