MERCER INTERNATIONAL INC.
Form 10-Q
May 03, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from _________ to _________

Commission File No.: 000-51826

MERCER INTERNATIONAL INC.

(Exact name of Registrant as specified in its charter)

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

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

(Address of office)

(604) 684-1099

(Registrant s telephone number, including area code)

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

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

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

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

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

The Registrant had 55,815,704 shares of common stock outstanding as at May 2, 2013.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE MONTHS ENDED MARCH 31, 2013

(Unaudited)

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands of Euros)

	March 31, 2013	December 31, 2012
ASSETS		
Current assets		
Cash and cash equivalents	110,664	104,239
Receivables	120,184	110,087
Inventories (Note 2)	112,908	118,300
Prepaid expenses and other	8,295	7,907
Deferred income tax	3,824	4,465
Total current assets	355,875	344,998
Long-term assets		
Property, plant and equipment	802,959	808,878
Deferred note issuance and other	11,622	12,162
Deferred income tax	15,104	17,565
	829,685	838,605
Total assets	1,185,560	1,183,603
LIABILITIES		
Current liabilities		
Accounts payable and other	97,645	89,950
Pension and other post-retirement benefit obligations (Note 4)	818	813
Debt (Note 3)	55,081	45,662
Total current liabilities	153,544	136,425
Long-term liabilities		
Debt (Note 3)	658,166	665,741
Unrealized interest rate derivative losses (Note 8)	45,513	50,678
Pension and other post-retirement benefit obligations (Note 4)	32,451	32,141
Capital leases and other	13,887	13,936
Deferred income tax	6,175	5,757
	756,192	768,253
Total liabilities	909,736	904,678
EQUITY		
Shareholders equity		
Share capital (Note 5)	248,757	248,371
Paid-in capital	(3,706)	(3,547)
Retained earnings	25,375	25,800
Accumulated other comprehensive income	21,570	25,181

Total shareholders equity	291,996	295,805
Noncontrolling interest (deficit)	(16,172)	(16,880)
Total equity	275,824	278,925
Total liabilities and equity	1,185,560	1,183,603

Commitments and contingencies (Note 10)

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

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands of Euros, except per share data)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Revenues		
Pulp	180,120	199,439
Energy and chemicals	18,152	18,919
	198,272	218,358
Costs and expenses		
Operating costs	165,098	177,770
Operating depreciation and amortization	14,731	14,287
	18,443	26,301
Selling, general and administrative expenses	8,895	10,058
Operating income	9,548	16,243
Other income (expense)		
Interest expense	(13,148)	(14,133)
Gain on derivative instruments (Note 8)	4,820	876
Other income (expense)	(70)	(410)
Total other income (expense)	(8,398)	(13,667)
Income before income taxes	1,150	2,576
Income tax benefit (provision)		
Current	3,271	(56)
Deferred	(4,138)	(676)
Net income	283	1,844
Less: net income attributable to noncontrolling interest	(708)	(671)
Net income (loss) attributable to common shareholders	(425)	1,173
Net income (loss) per share attributable to common shareholders (Note 7)		
Basic and diluted	(0.01)	0.02

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

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands of Euros)

	Three Months Ended March 31, 2013	2012
Net income	283	1,844
Other comprehensive income (loss), net of taxes		
Foreign currency translation adjustments, net of tax expense of 574 (2012 benefit of 90)	(3,528)	2,147
Change in unrecognized losses and prior service costs related to defined benefit plans, net of tax benefit of nil (2012 nil)	(93)	149
Change in unrealized losses on marketable securities, net of tax benefit of nil (2012 nil)	10	68
Other comprehensive income (loss), net of taxes	(3,611)	2,364
Total comprehensive income (loss)	(3,328)	4,208
Comprehensive income attributable to noncontrolling interest	(708)	(671)
Comprehensive income (loss) attributable to common shareholders	(4,036)	3,537

INTERIM CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

(Unaudited)

(In thousands of Euros)

	Three Months Ended March 31, 2013	2012
Net income (loss) attributable to common shareholders	(425)	1,173
Retained earnings, beginning of period	25,800	37,985
Retained earnings, end of period	25,375	39,158

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

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands of Euros)

	Three Months Ended March 31,	
	2013	**2012**
Cash flows from (used in) operating activities		
Net income	283	1,844
Adjustments to reconcile net income to cash flows from operating activities		
Unrealized gain on derivative instruments	(4,695)	(876)
Depreciation and amortization	14,794	14,350
Deferred income taxes	4,138	676
Stock compensation expense	267	868
Pension and other post-retirement expense, net of funding	121	(14)
Other	1,183	793
Changes in working capital		
Receivables	(9,704)	2,685
Inventories	5,746	11,738
Accounts payable and accrued expenses	10,597	2,649
Other	(782)	1,424
Net cash from (used in) operating activities	21,948	36,137
Cash flows from (used in) investing activities		
Purchase of property, plant and equipment	(11,395)	(8,465)
Proceeds on sale of property, plant and equipment	13	226
Net cash from (used in) investing activities	(11,382)	(8,239)
Cash flows from (used in) financing activities		
Repayment of debt	(20,545)	(10,126)
Proceeds from borrowings of debt	10,000	
Repayment of capital lease obligations	(700)	(611)
Proceeds from credit facilities, net	5,968	3,759
Payment of note issuance costs		(1,621)
Proceeds from government grants	730	630
Net cash from (used in) financing activities	(4,547)	(7,969)
Effect of exchange rate changes on cash and cash equivalents	406	(805)
Net increase in cash and cash equivalents	6,425	19,124
Cash and cash equivalents, beginning of period	104,239	105,072
Cash and cash equivalents, end of period	110,664	124,196

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

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MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Unaudited)

(In thousands of Euros)

	Three Months Ended March 31,	
	2013	2012
Supplemental disclosure of cash flow information		
Cash paid during the period for		
Interest	2,750	4,827
Income taxes	665	2,608
Supplemental schedule of non-cash investing and financing activities		
Acquisition of production and other equipment under capital lease obligations	170	
Increase (decrease) in accounts payable and accrued purchases for property, plant and equipment	(2,899)	463
Increase (decrease) in receivables of government grants for long-term assets		(638)

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

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 1. The Company and Summary of Significant Accounting Policies

Basis of Presentation

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

The interim consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC). The year-end Consolidated Balance Sheet data was derived from audited financial statements. The footnote disclosure included herein has been prepared in accordance with accounting principles generally accepted for interim financial statements in the United States (GAAP). The interim consolidated financial statements should be read together with the audited consolidated financial statements and accompanying notes included in the Company s latest annual report on Form 10-K for the fiscal year ended December 31, 2012. In the opinion of the Company, the unaudited interim consolidated financial statements contained herein contain all adjustments necessary 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 period amounts in the interim consolidated financial statements have been reclassified to conform to the current period presentation. Beginning in the second quarter of 2012, the Company has presented revenue from the sale of chemicals within energy and chemicals revenue in the Interim Consolidated Statement of Operations. This revenue had previously been presented within operating costs. Chemical revenue for the three month period ended March 31, 2013 was 2,861 (2012 2,808).

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

Use of Estimates

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

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 2. Inventories

	March 31, 2013	December 31, 2012
Raw materials	37,296	46,028
Finished goods	40,092	38,169
Spare parts and other	35,520	34,103
	112,908	118,300

Note 3. Debt

Debt consists of the following:

	March 31, 2013	December 31, 2012
Note payable to bank, included in a total loan credit facility of 827,950 to finance the construction related to the Stendal mill (a)	432,907	452,907
Senior notes, interest at 9.50% accrued and payable semi-annually, unsecured (b)	221,429	215,670
Credit agreement with a lender with respect to a revolving credit facility of C$40 million (c)	10,735	4,574
Term bank facility for a project at the Stendal mill of 17,000 (d)	10,000	
Loans payable to the noncontrolling shareholder of the Stendal mill (e)	37,088	36,620
Investment loan agreement with a lender with respect to a project at the Rosenthal mill of 4,351 (f)	1,088	1,632
Credit agreement with a bank with respect to a revolving credit facility of 25,000 (g)		
Credit agreement with a bank with respect to a revolving credit facility of 3,500 (h)		
	713,247	711,403
Less: current portion	(55,081)	(45,662)
Debt, less current portion	658,166	665,741

The Company made repayments under these facilities of 20,545 during the three month period ended March 31, 2013 (2012 10,126). As of March 31, 2013, the maturities of debt are as follows:

Matures	Amount
2013	32,908

2014	48,915
2015	44,000
2016	44,000
2017	543,424
Thereafter	
	713,247

Certain of the Company s debt instruments were issued under an indenture which, among other things, restricts its ability and the ability of its restricted subsidiaries to make certain payments. These limitations are subject to specific exceptions. As at March 31, 2013, the Company was in compliance with the terms of the indenture.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 3. Debt (continued)

(a) Note payable to bank, included in a total loan facility of 827,950 to finance the construction related to the Stendal mill (Stendal Loan Facility), interest at rates varying from Euribor plus 0.90% to Euribor plus 1.80% (rates on amounts of borrowing at March 31, 2013 range from 1.39% to 2.14%), principal due in required installments beginning September 30, 2006 until September 30, 2017, collateralized by the gross assets of the Stendal mill, with 48% and 32% guaranteed by the Federal Republic of Germany and the State of Saxony-Anhalt, respectively, of up to 372,907 of outstanding principal, subject to a debt service reserve account (DSRA) for purposes of paying amounts due in the following 12 months under the terms of the Stendal Loan Facility; payment of dividends is only permitted if certain cash flow requirements are met. See Note 8 Derivative Transactions for a discussion of the Company s variable-to-fixed interest rate swap that was put in place to effectively fix the interest rate on the Stendal Loan Facility.

On March 13, 2009, the Company finalized an agreement with its lenders to amend its Stendal Loan Facility. The amendment deferred approximately 164,000 of scheduled principal payments until the maturity date, September 30, 2017. The amendment also provided for a 100% cash sweep, referred to as the Cash Sweep , of any cash, in excess of a 15,000 working capital reserve and the Guarantee Amount, as discussed in Note 10(a) Commitments and Contingencies, and other amounts as contemplated in the amendment, held by Stendal which will be used first to fund the DSRA to a level sufficient to service the amounts due and payable under the Stendal Loan Facility during the then following 12 months, which means the DSRA is Fully Funded , and second to prepay the deferred principal amounts. As at March 31, 2013, the DSRA balance was 32,986 and was not Fully Funded.

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

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

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

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

(c) Credit agreement with respect to a revolving credit facility of up to C$40.0 million for the Celgar mill. The credit facility matures May 2013. Borrowings under the credit facility are collateralized by the mill s inventory and receivables and are restricted by a borrowing base calculated on the mill s inventory and receivables. Canadian dollar denominated amounts bear interest at bankers acceptance plus 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 March 31, 2013, this facility was accruing interest at a rate of approximately 5.00%, C$14.0 million of this facility was drawn, C$1.7 million was supporting letters of credit and approximately C$22.3 million was available. The Company is in the process of extending the maturity date of the facility.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 3. Debt (continued)

(d) A 17,000 amortizing term facility to partially finance a project, referred to as Project Blue Mill , which is expected to increase the Stendal mill s annual pulp production capacity by 30,000 air-dried metric tonnes and includes the installation of an additional 40 megawatt steam turbine. The facility, 80% of which is guaranteed by the State of Saxony-Anhalt, bears interest at a rate of Euribor plus 3.5% per annum and is available for disbursement up to August 31, 2013. The interest period for the facility, at the choice of the Company, will be of one, three or six months duration and interest is paid on the last day of the interest period selected. The facility, together with accrued interest, is scheduled to mature in September 2017. The facility will be repaid semi-annually, commencing September 30, 2013, is collateralized by the gross assets of the Stendal mill, and will be non-recourse to the Company. As at March 31, 2013, 10,000 had been drawn on this facility and was accruing interest at a rate of approximately 3.83%.

As part of the term facility, the Company was required to open an investment account with the lender for the purpose of managing project costs and is required to deposit all funding associated with Project Blue Mill in this account. As at March 31, 2013, the balance in the investment account was 2,894.

(e) Loans of 26,760 payable by the Stendal mill to its noncontrolling shareholder bear interest at a rate of 7.00% per annum and are due in 2017, provided that the Project Blue Mill facility (Note 3(d)) and the Stendal Loan Facility (Note 3(a)) have been fully repaid on such date. The loans are unsecured, subordinated to all liabilities of the Stendal mill, non-recourse to the Company and its restricted subsidiaries. One of the loans, which has a principal amount of 440, may be repaid prior to October 1, 2017 if the DSRA has been Fully Funded for the first time and this loan is subordinated to all liabilities of the Stendal mill only until such time as the DSRA is Fully Funded for the first time.

As at March 31, 2013, accrued interest on these loans was 10,328. As at December 31, 2012, accrued interest on these loans was 9,860.

(f) A four-year amortizing investment loan agreement with a lender relating to the wash press project at the Rosenthal mill with a total facility of 4,351 bearing interest at the rate of Euribor plus 2.75% that matures February 2014. Borrowings under this agreement are secured by the wash press equipment. As at March 31, 2013, the balance outstanding was 1,088 and was accruing interest at a rate of 3.13%.

(g) A 25,000 working capital facility at the Rosenthal mill that matures in October 2016. Borrowings under the facility are collateralized by the mill s inventory and receivables and bear interest at Euribor plus 3.50%. As at March 31, 2013, approximately 1,000 of this facility was supporting bank guarantees leaving approximately 24,000 available.

(h) A 3,500 facility at the Rosenthal mill that matures in December 2015. Borrowings under this facility bear interest at the rate of the three-month Euribor plus 3.50% and are secured by certain land at the Rosenthal mill. As at March 31, 2013, approximately 1,300 of this facility was supporting bank guarantees leaving approximately 2,200 available.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 4. Pension and Other Post-Retirement Benefit Obligations

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

Pension benefits are based on employees earnings and years of service. The Celgar Plans are funded by contributions from the Company based on actuarial estimates and statutory requirements. Pension contributions during the three month period ended March 31, 2013 totaled 497 (2012 501).

Effective December 31, 2008, the defined benefit plan was closed to new members. In addition, the defined benefit service accrual ceased on December 31, 2008, and members began to receive pension benefits, at a fixed contractual rate, under a new defined contribution plan effective January 1, 2009. During the three month period ended March 31, 2013, the Company made contributions of 174 (2012 161) to this plan.

Information about the Celgar Plans, in aggregate for the three month periods ended March 31, 2013 and March 31, 2012 is as follows:

	Three Months ended March 31,			
	2013		2012	
	Pension Benefits	Post-Retirement Benefits	Pension Benefits	Post-Retirement Benefits
Service cost	26	146	27	138
Interest cost	355	214	373	214
Expected return on plan assets	(412)		(401)	
Recognized net loss	278	23	276	1
Net periodic benefit cost	247	383	275	353

The Company participates in a multiemployer plan for hourly-paid employees at the Celgar mill. The contributions to this plan are determined based on an amount per hour worked pursuant to a collective bargaining agreement. The Company has no current or future contribution obligations in excess of the contractual contributions. During the three month period ended March 31, 2013, the Company made contributions of 381 (2012 477) to this plan.

Note 5. Share Capital

Common shares

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

As at March 31, 2013 and December 31, 2012, the Company had 55,815,704 common shares issued and outstanding.

Share Repurchase Program

In July 2012, the Company s Board of Directors authorized a share repurchase program (the Program) to repurchase up to approximately $14.4 million of the Company s outstanding common shares from time to time over a period ending August 2013. During the three month period ended

March 31, 2013 and the twelve month period ended December 31, 2012, the Company did not repurchase any of its common shares.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 5. Share Capital (continued)

Preferred shares

The Company has authorized 50,000,000 preferred shares with $1 par value issuable in series, of which 2,000,000 shares have been designated as Series A. The preferred shares may be issued in one or more series and with such designations and preferences for each series as shall be stated in the resolutions providing for the designation and issue of each such series adopted by the Board of Directors of the Company. The Board of Directors is authorized by the Company s articles of incorporation to determine the voting, dividend, redemption and liquidation preferences pertaining to each such series. As at March 31, 2013, no preferred shares had been issued by the Company.

Note 6. Stock-Based Compensation

The Company has a stock incentive plan (the 2010 Plan) which provides for options, restricted stock rights, restricted shares, performance shares, performance share units (PSUs) and stock appreciation rights to be awarded to employees, consultants and non-employee directors. As at March 31, 2013, after factoring in all allocated shares, there remain approximately 1.1 million common shares available for grant pursuant to the 2010 Plan.

During the three month period ended March 31, 2013, 40,000 restricted shares vested.

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

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Net income (loss) attributable to common shareholders:		
Basic and diluted	(425)	1,173
Net income (loss) per share attributable to common shareholders:		
Basic and diluted	(0.01)	0.02
Weighted average number of common shares outstanding:		
Basic[(1)]	55,632,982	55,554,830
Effect of dilutive instruments:		
PSUs		277,676
Stock options		28,702
Diluted	55,632,982	55,861,208

(1) The basic weighted average number of shares excludes 156,500 restricted shares which have been issued, but have not vested as at March 31, 2013 (2012 198,000 restricted shares).

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

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

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

	Three Months Ended March 31,	
	2013	2012
PSUs	786,129	
Restricted shares	156,500	198,000
Stock options	175,000	45,000

Note 8. Derivative Transactions

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

Derivative assets are presented in prepaid expenses and other, and derivative liabilities are presented in unrealized interest rate derivative losses in the Consolidated Balance Sheet.

Interest Rate Derivative

During 2004, the Company entered into certain variable-to-fixed interest rate swaps in connection with the Stendal mill with respect to an aggregate maximum amount of approximately 612,600 of the principal amount of the indebtedness under the Stendal Loan Facility. Under the remaining interest rate swap, the Company pays a fixed rate and receives a floating rate with the interest payments being calculated on a notional amount. Currently, the contract has an aggregate notional amount of 357,576 at a fixed interest rate of 5.28% and it matures in October 2017 (which for the most part matches the maturity of the Stendal Loan Facility).

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

Pulp Price Derivatives

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

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

	Three Months Ended March 31, 2013	2012
Interest rate derivative contract	5,165	876
Pulp price derivative contracts	(345)	
	4,820	876

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 9. Financial Instruments

The fair value of financial instruments is summarized as follows:

	March 31, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	110,664	110,664	104,239	104,239
Marketable securities	196	196	184	184
Receivables	120,184	120,184	110,087	110,087
Pulp price derivative contracts asset	280	280	745	745
Accounts payable and other	97,645	97,645	89,950	89,950
Debt	713,247	709,622	711,403	700,001
Interest rate derivative contract liability	45,513	45,513	50,678	50,678

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

Fair Value Measurement and Disclosure

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 the Fair Value Measurements and Disclosures topic of the FASB Accounting Standards Codification, and are as follows:

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

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

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

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

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

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MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 9. Financial Instruments (continued)

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

	Fair value measurements at March 31, 2013 using:			
Description	Level 1	Level 2	Level 3	Total
Assets				
Marketable securities	196			196
Pulp price derivative contracts		280		280
	196	280		476
Liabilities				
Interest rate derivative contract		45,513		45,513

	Fair value measurements at December 31, 2012 using:			
Description	Level 1	Level 2	Level 3	Total
Assets				
Marketable securities	184			184
Pulp price derivative contracts		745		745
	184	745		929
Liabilities				
Interest rate derivative contract		50,678		50,678

Note 10. Commitments and Contingencies

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

The 10,000 was initially recognized as an increase in cash and a corresponding increase in accounts payable and other. As civil works remediation steps are agreed to with the noncontrolling shareholder an agreed to portion of the payable is reversed with the offset recorded in operating costs to offset the remediation expenditures. As at March 31, 2013, the Company had Guarantee Amount proceeds of 1,768 remaining in accounts payable and other.

(b) The Company is involved in a property transfer tax dispute with respect to the Celgar mill and certain other legal actions and claims arising in the ordinary course of business. Celgar had previously paid the property transfer tax assessment. The court proceedings of our appeal commenced during the first quarter of 2013. A final court date for the appeal is scheduled during the second quarter of 2013. The outcome of this appeal process is uncertain. In addition, while the outcome of any legal actions and claims cannot be predicted with certainty, it is the opinion of management that the outcome of any such claim which is pending or threatened, either individually or on a combined basis, will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 10. Commitments and Contingencies (continued)

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

(d) As at March 31, 2013, the Company had entered into capital commitments of approximately 11,200 at the Stendal mill as part of Project Blue Mill.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 11. Restricted Group Supplemental Disclosure

The terms of the indenture governing our Senior Notes require that we provide the results of operations and financial condition of Mercer International Inc. and our restricted subsidiaries under the indenture, collectively referred to as the Restricted Group . As at and during the three months ended March 31, 2013 and 2012, the Restricted Group was comprised of Mercer International Inc., certain holding subsidiaries and our Rosenthal and Celgar mills. The Restricted Group excludes the Stendal mill.

Combined Condensed Balance Sheets

	March 31, 2013			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
ASSETS				
Current assets				
Cash and cash equivalents	52,032	58,632		110,664
Receivables	69,944	50,240		120,184
Inventories	72,073	40,835		112,908
Prepaid expenses and other	4,834	3,461		8,295
Deferred income tax	2,190	1,634		3,824
Total current assets	201,073	154,802		355,875
Long-term assets				
Property, plant and equipment	340,459	462,500		802,959
Deferred note issuance and other	6,322	5,300		11,622
Deferred income tax	9,222	5,882		15,104
Due from unrestricted group	104,581		(104,581)	
Total assets	661,657	628,484	(104,581)	1,185,560
LIABILITIES				
Current liabilities				
Accounts payable and other	52,688	44,957		97,645
Pension and other post-retirement benefit obligations	818			818
Debt	11,823	43,258		55,081
Total current liabilities	65,329	88,215		153,544
Long-term liabilities				
Debt	221,430	436,736		658,166
Due to restricted group		104,581	(104,581)	
Unrealized interest rate derivative losses		45,513		45,513
Pension and other post-retirement benefit obligations	32,451			32,451
Capital leases and other	6,095	7,792		13,887
Deferred income tax	6,175			6,175
Total liabilities	331,480	682,837	(104,581)	909,736

EQUITY				
Total shareholders equity (deficit)	330,177	(38,181)		291,996
Noncontrolling interest (deficit)		(16,172)		(16,172)
Total liabilities and equity	661,657	628,484	(104,581)	1,185,560

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 11. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Balance Sheets

	December 31, 2012			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
ASSETS				
Current assets				
Cash and cash equivalents	36,714	67,525		104,239
Receivables	61,212	48,875		110,087
Inventories	74,786	43,514		118,300
Prepaid expenses and other	5,811	2,096		7,907
Deferred income tax	2,188	2,277		4,465
Total current assets	180,711	164,287		344,998
Long-term assets				
Property, plant and equipment	345,311	463,567		808,878
Deferred note issuance and other	6,607	5,555		12,162
Deferred income tax	9,179	8,386		17,565
Due from unrestricted group	102,311		(102,311)	
Total assets	644,119	641,795	(102,311)	1,183,603
LIABILITIES				
Current liabilities				
Accounts payable and other	42,106	47,844		89,950
Pension and other post-retirement benefit obligations	813			813
Debt	5,662	40,000		45,662
Total current liabilities	48,581	87,844		136,425
Long-term liabilities				
Debt	216,214	449,527		665,741
Due to restricted group		102,311	(102,311)	
Unrealized interest rate derivative losses		50,678		50,678
Pension and other post-retirement benefit obligations	32,141			32,141
Capital leases and other	6,073	7,863		13,936
Deferred income tax	5,757			5,757
Total liabilities	308,766	698,223	(102,311)	904,678
EQUITY				
Total shareholders equity (deficit)	335,353	(39,548)		295,805

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

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 11. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Statements of Operations

	Three months ended March 31, 2013			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	100,240	79,880		180,120
Energy and chemicals	7,090	11,062		18,152
	107,330	90,942		198,272
Operating costs	89,523	75,575		165,098
Operating depreciation and amortization	8,191	6,540		14,731
Selling, general and administrative expenses	5,716	3,179		8,895
	103,430	85,294		188,724
Operating income	3,900	5,648		9,548
Other income (expense)				
Interest expense	(5,866)	(8,930)	1,648	(13,148)
Gain (loss) on derivative instruments	(345)	5,165		4,820
Other income (expense)	1,535	43	(1,648)	(70)
Total other income (expense)	(4,676)	(3,722)		(8,398)
Income (loss) before income taxes	(776)	1,926		1,150
Income tax benefit (provision)	(1,016)	149		(867)
Net income (loss)	(1,792)	2,075		283
Less: net income attributable to noncontrolling interest		(708)		(708)
Net income (loss) attributable to common shareholders	(1,792)	1,367		(425)

	Three months ended March 31, 2012			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	109,889	89,550		199,439
Energy and chemicals	7,991	10,928		18,919

	117,880	100,478		218,358
Operating costs	98,336	79,434		177,770
Operating depreciation and amortization	7,640	6,647		14,287
Selling, general and administrative expenses	6,521	3,537		10,058
	112,497	89,618		202,115
Operating income	5,383	10,860		16,243
Other income (expense)				
Interest expense	(5,810)	(9,664)	1,341	(14,133)
Gain on derivative instruments		876		876
Other income (expense)	825	106	(1,341)	(410)
Total other income (expense)	(4,985)	(8,682)		(13,667)
Income before income taxes	398	2,178		2,576
Income tax benefit (provision)	(715)	(17)		(732)
Net income (loss)	(317)	2,161		1,844
Less: net income attributable to noncontrolling interest		(671)		(671)
Net income (loss) attributable to common shareholders	(317)	1,490		1,173

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 11. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Statements of Cash Flows

	Three months ended March 31, 2013		
	Restricted Group	Unrestricted Subsidiaries	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss)	(1,792)	2,075	283
Adjustments to reconcile net income (loss) to cash flows from operating activities			
Unrealized loss (gain) on derivative instruments	470	(5,165)	(4,695)
Depreciation and amortization	8,254	6,540	14,794
Deferred income taxes	991	3,147	4,138
Stock compensation expense	267		267
Pension and other post-retirement expense, net of funding	121		121
Other	413	770	1,183
Changes in working capital			
Receivables	(8,339)	(1,365)	(9,704)
Inventories	3,067	2,679	5,746
Accounts payable and accrued expenses	10,505	92	10,597
Other(1)	(1,714)	932	(782)
Net cash from (used in) operating activities	12,243	9,705	21,948
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(2,645)	(8,750)	(11,395)
Proceeds on sale of property, plant and equipment	13		13
Net cash from (used in) investing activities	(2,632)	(8,750)	(11,382)
Cash flows from (used in) financing activities			
Repayment of debt	(545)	(20,000)	(20,545)
Proceeds from borrowings of debt		10,000	10,000
Repayment of capital lease obligations	(122)	(578)	(700)
Proceeds from credit facilities, net	5,968		5,968
Proceeds from government grants		730	730
Net cash from (used in) financing activities	5,301	(9,848)	(4,547)
Effect of exchange rate changes on cash and cash equivalents	406		406
Net increase (decrease) in cash and cash equivalents	15,318	(8,893)	6,425

Cash and cash equivalents, beginning of period	36,714	67,525	104,239
Cash and cash equivalents, end of period	52,032	58,632	110,664

(1) Includes intercompany related transactions.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 11. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Statements of Cash Flows

	Three months ended March 31, 2012		
	Restricted Group	Unrestricted Subsidiaries	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss)	(317)	2,161	1,844
Adjustments to reconcile net income (loss) to cash flows from operating activities			
Unrealized gain on derivative instruments		(876)	(876)
Depreciation and amortization	7,703	6,647	14,350
Deferred income taxes	676		676
Stock compensation expense	868		868
Pension and other post-retirement expense, net of funding	(14)		(14)
Other	58	735	793
Changes in working capital			
Receivables	(2,110)	4,795	2,685
Inventories	4,018	7,720	11,738
Accounts payable and accrued expenses	5,535	(2,886)	2,649
Other[1]	(6,474)	7,898	1,424
Net cash from (used in) operating activities	9,943	26,194	36,137
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(4,218)	(4,247)	(8,465)
Proceeds on sale of property, plant and equipment	186	40	226
Net cash from (used in) investing activities	(4,032)	(4,207)	(8,239)
Cash flows from (used in) financing activities			
Repayment of debt	(543)	(9,583)	(10,126)
Repayment of capital lease obligations	(186)	(425)	(611)
Proceeds from credit facilities, net	3,759		3,759
Payment of note issuance costs		(1,621)	(1,621)
Proceeds from government grants	630		630
Net cash from (used in) financing activities	3,660	(11,629)	(7,969)
Effect of exchange rate changes on cash and cash equivalents	(805)		(805)
Net increase in cash and cash equivalents	8,766	10,358	19,124

Cash and cash equivalents, beginning of period	44,829	60,243	105,072
Cash and cash equivalents, end of period	53,595	70,601	124,196

(1) Includes intercompany related transactions.

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

In this document: (i) unless the context otherwise requires, references to we , our , us , the Company or Mercer mean Mercer International Inc. its subsidiaries; (ii) references to Mercer Inc. mean the Company excluding its subsidiaries; (iii) information is provided as of March 31, 2013, unless otherwise stated; (iv) all references to monetary amounts are to Euros , the lawful currency adopted by most members of the European Union, unless otherwise stated; (v) refers to Euros, $ refers to U.S. dollars and C$ refers to Canadian dollars; (vi) ADMTs refers to air-dried metric tonnes; (vii) MW refers to megawatts; and (viii) MWh refers to megawatt hours.

Results of Operations

General

We operate three northern bleached softwood kraft, referred to as NBSK , pulp mills through our wholly owned subsidiaries, Rosenthal and Celgar, and our 74.9% owned subsidiary, Stendal, which have a consolidated annual production capacity of approximately 1.5 million ADMTs.

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

Current Market Environment

Pulp prices marginally increased in the first quarter of 2013. However, we believe that overall prices are still low given current projected supply and demand levels. At the end of the first quarter of 2013, list prices in Europe were approximately $840 per ADMT and in North America and China were approximately $900 and $700 per ADMT, respectively.

We currently expect strong demand from China as purchasers re-stock inventories which, along with annual maintenance shuts by producers, should cause NBSK pulp prices to continue to gradually increase in the medium term.

Summary Financial Highlights

	Three Months Ended March 31,	
	2013	2012
	(in thousands, other than per share amounts)	
Pulp revenues	180,120	199,439
Energy and chemical revenues	18,152	18,919
Operating income	9,548	16,243
Gain on derivative instruments	4,820	876
Income tax benefit (provision)	(867)	(732)
Net income (loss)(1)	(425)	1,173
Net income (loss) per share(1)(2)	(0.01)	0.02

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

Selected Production, Sales and Other Data

	Three Months Ended March 31, 2013	2012
Consolidated		
Pulp production (000 ADMTs)	361.2	380.3
Scheduled production downtime (000 ADMTs)		
Scheduled production downtime (days)		
Pulp sales (000 ADMTs)	356.7	384.8
Average NBSK pulp list prices in Europe ($/ADMT)[1]	832	837
Average NBSK pulp list prices in Europe (/ADMT)	630	638
Average pulp sales realizations (/ADMT)[2]	499	512
Energy production (000 MWh)	424.4	436.2
Energy sales (000 MWh)	173.6	182.4
Average energy sales realizations (/MWh)	88	88
Average Spot Currency Exchange Rates		
/ $[3]	0.7580	0.7623
C$ / $[3]	1.0087	1.0009
C$ / [4]	1.3319	1.3129

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

Three Months Ended March 31, 2013 Compared to Three Months Ended March 31, 2012

Total revenues for the three months ended March 31, 2013 decreased by approximately 9% to 198.3 million from 218.4 million in the same period in 2012, due to lower pulp revenues and energy and chemical revenues and a weaker U.S. dollar relative to the Euro.

Pulp revenues for the three months ended March 31, 2013 decreased to 180.1 million from 199.4 million in the comparative quarter of 2012, primarily due to the combined effect of lower pulp sales volumes and average pulp sales realizations and a weaker U.S. dollar relative to the Euro. The U.S. dollar was approximately 1% weaker versus the Euro in the current quarter, compared to the same quarter of last year.

Energy and chemical revenues decreased by approximately 4% to 18.2 million in the first quarter from 18.9 million in the same quarter last year, primarily as a result of lower pulp production at our Celgar mill.

Average list prices for NBSK pulp in Europe were approximately $832 (630) per ADMT in the current quarter, compared to approximately $837 (638) per ADMT in the same quarter last year. In the first quarter of 2013, average pulp sales realizations decreased by approximately 3% to 499 per ADMT from approximately 512 per ADMT in the same quarter last year, primarily due to lower pulp prices and a weaker U.S. dollar relative to the Euro.

Pulp production decreased by approximately 5% to 361,164 ADMTs in the current quarter from 380,342 ADMTs in the same quarter of 2012, due to decreased pulp production at our Celgar and Stendal mills. We have 11 days (approximately 16,000 ADMTs) of maintenance downtime scheduled for our Celgar mill in the second quarter of 2013 in order to perform annual maintenance.

Pulp sales volumes decreased by approximately 7% to 356,660 ADMTs in the current quarter from 384,826 ADMTs in the comparative quarter, primarily due to lower sales to China and the United States.

Costs and expenses in the first quarter of 2013 decreased by 7% to 188.7 million from 202.1 million in the comparative period of 2012, primarily due to lower pulp sales volumes and fiber costs, partially offset by higher natural gas costs at our German mills, resulting from higher usage and prices.

In the first quarter of 2013, operating depreciation and amortization marginally increased to 14.7 million from 14.3 million in the same quarter last year. Selling, general and administrative expenses were 8.9 million in the first quarter of 2013, compared to 10.1 million in the first quarter of 2012.

Transportation costs decreased to 16.8 million in the first quarter of 2013 from 18.0 million in the first quarter of 2012, primarily due to lower pulp sales volumes.

On average, our per unit fiber costs in the current quarter decreased by approximately 2% from the same period in 2012, primarily due to overall lower fiber prices. During the first quarter of 2013, fiber costs at our German mills were marginally lower than the comparative period in 2012, when fiber prices were near record highs. Increased demand from the European pellet and board producers, reduced wood supply because of longer than normal winter weather conditions and lower availability of trucking transportation kept fiber prices at relatively high levels in the current quarter. Fiber costs at our Celgar mill decreased as a result of increased sawmill activity in the region. The recent extreme weather conditions are expected to put upward pressure on fiber costs at our German mills in the short term, whereas, we expect fiber costs at our Celgar mill to continue to decrease in the short term.

For the first quarter of 2013, operating income decreased to 9.5 million from 16.2 million in the comparative quarter of 2012, primarily due to the combined effect of lower pulp prices and pulp sales volumes.

Interest expense in the first quarter of 2013 decreased to 13.1 million from 14.1 million in the comparative quarter of 2012, primarily due to lower debt levels associated with the Stendal mill.

We recorded a net derivative gain of 4.8 million, which includes a 0.3 million loss related to fixed price pulp swap contracts entered into in the fourth quarter of 2012 and an unrealized gain of approximately 5.1 million on the mark to market adjustment of our Stendal mill s interest rate derivative, compared to an unrealized derivative gain of 0.9 million in the same quarter of last year.

During the current quarter, we recorded a net income tax expense of 0.9 million, compared to an expense of 0.7 million in the same quarter of 2012.

Noncontrolling shareholder s interest in the Stendal mill s income in each of the first quarters of 2013 and 2012 was 0.7 million.

We reported a net loss attributable to common shareholders of 0.4 million, or 0.01 per basic and diluted share, for the first quarter of 2013, which included a total net non-cash unrealized gain of 4.7 million on the fixed price pulp swaps and Stendal interest rate derivative, partially offset by a non-cash charge for stock compensation of 0.3 million. In the first quarter of 2012, net income attributable to common shareholders was 1.2 million, or 0.02 per basic and diluted share, which included a non-cash unrealized gain of 0.9 million, or 0.02 per basic share, on the Stendal interest rate derivative, offset by a non-cash charge for stock compensation of 0.9 million.

Operating EBITDA in the first quarter of 2013 was 24.3 million, compared to 30.6 million in the first quarter of 2012. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. Management uses Operating EBITDA as a benchmark measurement of its own operating results, and as a benchmark relative to its competitors. Management considers it to be a meaningful supplement to operating income (loss) as a performance measure primarily because depreciation expense and non-recurring capital asset impairment charges are not an actual cash cost, and depreciation expense varies widely from company to company in a manner that management considers largely independent of the underlying cost efficiency of their operating facilities. In addition, we believe Operating EBITDA is commonly used by securities analysts, investors and other interested parties to evaluate our financial performance.

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

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

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

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
	(in thousands)	
Net income (loss) attributable to common shareholders	(425)	1,173
Net income attributable to noncontrolling interest	708	671
Income tax provision (benefit)	867	732
Interest expense	13,148	14,133
Gain on derivative instruments	(4,820)	(876)
Other expense (income)	70	410
Operating income	9,548	16,243
Add: Depreciation and amortization	14,794	14,350
Operating EBITDA	24,342	30,593

Liquidity and Capital Resources

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

	As at March 31, 2013	As at December 31, 2012
	(in thousands)	
Financial Position		
Cash and cash equivalents	110,664	104,239
Working capital	202,331	208,573
Total assets	1,185,560	1,183,603
Long-term liabilities	756,192	768,253
Total equity	275,824	278,925

As at March 31, 2013, our cash and cash equivalents increased to 110.7 million from 104.2 million and working capital had decreased to 202.3 million from 208.6 million at the end of 2012.

Sources and Uses of Funds

Our principal sources of funds are cash flows from operations, cash and cash equivalents on hand and the revolving working capital loan facilities for our Celgar and Rosenthal mills. Our principal uses of funds consist of operating expenditures, payments of principal and interest on the project loan facilities relating to our development of the Stendal mill, referred to as Stendal Loan Facility , and for its Project Blue Mill, capital expenditures and interest payments on our outstanding 9.5% Senior Notes, referred to as the Senior Notes .

Debt Covenants

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

As at March 31, 2013, we were in compliance with all of the covenants of our indebtedness.

Our Stendal mill has established the Stendal Loan Facility and a project loan facility for Project Blue Mill, collectively referred to as the Facilities , which require Stendal to maintain a similar leverage ratio of total debt thereunder to EBITDA, referred to as the Stendal Ratio . An aggregate of 80% of the principal amount of the tranches under the Facilities are severally guaranteed by German federal and state governments, and the Facilities are without recourse to the Restricted Group which is comprised of Mercer Inc., the Rosenthal and Celgar mills, and certain holding subsidiaries.

Because of, among other things, volatility in foreign exchange rates and pulp prices, currently we cannot assure that the Stendal mill will be in compliance with the Stendal Ratio as of June 30, 2013. We have entered into discussions with the Stendal mill s lenders with respect to a satisfactory amendment or waiver, if required. Additionally, we have the right to cure any breach of the Stendal Ratio by providing additional equity to Stendal within 20 business days of being notified of such breach by the lenders. In the event that the Stendal mill is not in compliance with the Stendal Ratio, we are not able to acquire a satisfactory amendment or waiver of such covenant and we do not undertake to cure the breach by providing additional capital to Stendal, it would constitute an Event of Default under the Facilities. If such Event of Default occurs and after careful consideration of the reasonable concerns of Stendal or if the stipulated majority of the lenders have reasonably determined that such default has caused Stendal s ability to perform its obligations under the Facilities to be materially impaired, the lenders may provide notice cancelling and accelerating the Facilities and demanding full payment of all amounts outstanding thereunder. In the current circumstances, we do not believe Stendal s lenders would be permitted to accelerate and cancel the Facilities; however, we cannot assure you of the same. If Stendal s lenders did accelerate and cancel the Facilities, this would have a material adverse effect on the Stendal mill, our business and our consolidated results of operations.

Cash Flow Analysis

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

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

Cash provided by operating activities decreased to 21.9 million in the three months ended March 31, 2013 from 36.1 million in the comparative period of 2012, primarily due to an increase in receivables, which used cash of 9.7 million in the current quarter, compared to a decrease providing cash of 2.7 million in the same period of 2012. An increase in accounts payable and accrued expenses provided cash of 10.6 million, compared to 2.6 million in the same period of 2012. A decrease in inventories provided cash of 5.7 million in the three months ended March 31, 2013, compared to a decrease in inventories providing cash of 11.7 million in the same period of 2012.

Cash Flows from Investing Activities. Investing activities in the three months ended March 31, 2013 used cash of 11.4 million, compared to using cash of 8.2 million in the same period of 2012. Capital expenditures in the three months ended March 31, 2013 used cash of 11.4 million, compared to 8.5 million in the same period of 2012. Capital expenditures related to Project Blue Mill used cash of 8.7 million in the current quarter.

Cash Flows from Financing Activities. In the three months ended March 31, 2013, financing activities used cash of 4.5 million, compared to using cash of 8.0 million in the same period of 2012. In the current quarter, principal repayments under the Stendal Facility used cash of 20.0 million, compared to 9.6 million in the same period of 2012. During the current quarter, borrowing under the loan facility for Project Blue Mill provided cash of 10.0 million. Net borrowing from our revolving credit facilities provided cash of 6.0 million in the current quarter, compared to 3.8 million in the same period of 2012. In the three months ended March 31, 2013 and 2012, proceeds of government grants provided cash of 0.7 million and 0.6 million respectively.

Capital Commitments and Future Liquidity

As at March 31, 2013, we had approximately 11.2 million of capital commitments related to our 40.0 million Project Blue Mill at the Stendal mill and deposited 2.9 million in a separate investment account to manage Project Blue Mill s costs and funding. Project Blue Mill has also received an investment decree, determining that it qualifies for up to 12.0 million in governmental grants, comprised of 9.2 million of investment incentives and 2.8 million of tax grants. The actual receipt of such grants is subject to the Stendal mill satisfying all governmental rules including verification. The investment decree is a condition of our accessing the Project Blue Mill loan facility. As at March 31, 2013, the Stendal mill, based on expenditures to date, had applied for 4.4 million in grants and was awaiting approval and receipt of 3.7 million.

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

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

Contractual Obligations and Commitments

There were no material changes outside the ordinary course to any of our material contractual obligations during the three months ended March 31, 2013.

The collective agreement with our hourly workers at our Rosenthal mill expires on May 31, 2013. We consider the relationships with our employees at our Rosenthal mill to be good and, although no assurance can be provided, we currently expect to enter into a new labor agreement with our Rosenthal mill s employees without any significant work stoppage.

Foreign Currency

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

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

In the three months ended March 31, 2013, accumulated other comprehensive income decreased by 3.6 million to 21.6 million, primarily due to the foreign currency translation adjustment.

Based upon the exchange rate at March 31, 2013, the U.S. dollar has weakened by approximately 4% in value against the Euro since March 31, 2012. See Quantitative and Qualitative Disclosures about Market Risk .

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

General

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

The following is a discussion of the results of operations and financial condition of the Restricted Group. For further information regarding the Restricted Group including, without limitation, a reconciliation to our consolidated results of operations, see Note 11 of our Interim Consolidated Financial Statements included herein.

Summary Financial Highlights for the Restricted Group

	Three Months Ended March 31,	
	2013	2012
	(in thousands)	
Pulp revenues	100,240	109,889
Energy and chemical revenues	7,090	7,991
Operating income	3,900	5,383
Loss on derivative instruments	(345)	
Income tax benefit (provision)	(1,016)	(715)
Net loss	(1,792)	(317)

Selected Production, Sales and Other Data for the Restricted Group

	Three Months Ended March 31, 2013	2012
Consolidated		
Pulp production (000 ADMTs)	205.6	218.6
Scheduled production downtime (000 ADMTs)		
Scheduled production downtime (days)		
Pulp sales (000 ADMTs)	199.3	213.5
Average NBSK pulp list prices in Europe ($/ADMT)[1]	832	837
Average NBSK pulp list prices in Europe (/ADMT)	630	638
Average pulp sales realizations (/ADMT)[2]	503	514
Energy production (000 MWh)	230.4	240.2
Energy sales (000 MWh)	79.9	88.8
Average energy sales realizations (/MWh)	89	90
Average Spot Currency Exchange Rates		
/ $[3]	0.7580	0.7623
C$ / $[3]	1.0087	1.0009
C$ / [4]	1.3319	1.3129

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

Restricted Group Results Three Months Ended March 31, 2013 Compared to Three Months Ended March 31, 2012

Total revenues for the Restricted Group decreased by approximately 9% to 107.3 million in the first quarter of 2013, compared to 117.9 million in the first quarter of 2012, primarily due to lower pulp and energy and chemical revenues and a weaker U.S. dollar relative to the Euro. The U.S. dollar was approximately 1% weaker versus the Euro in the first quarter of 2013, compared to the first quarter of 2012.

Pulp revenues for the Restricted Group for the three months ended March 31, 2013 decreased to 100.2 million from 109.9 million in the comparative period of 2012, primarily due to the combined effect of lower pulp sales volumes and average pulp sales realizations and a weaker U.S. dollar relative to the Euro. Energy revenues decreased by approximately 11% in the current quarter to 7.1 million from 8.0 million in the same period last year, primarily as a result of lower pulp production at our Celgar mill.

Average list prices for NBSK pulp in Europe were approximately $832 (630) per ADMT in the current quarter, compared to $837 (638) per ADMT in the same quarter last year. In the first quarter of 2013, average pulp sales realizations for the Restricted Group decreased by approximately 2% to 503 per ADMT from 514 per ADMT in the same period last year due to lower pulp prices and a weaker U.S. dollar relative to the Euro.

Pulp production for the Restricted Group decreased by approximately 6% to 205,550 ADMTs in the first quarter of 2013 from 218,620 ADMTs in the same period of 2012, primarily due to decreased pulp production at our Celgar mill. We have 11 days (approximately 16,000 ADMTs) of maintenance downtime scheduled for our Celgar mill in the second quarter of 2013 in order to perform annual maintenance.

Pulp sales volumes of the Restricted Group decreased by approximately 7% to 199,325 ADMTs in the first quarter of 2013 from 213,472 ADMTs in the comparative period of 2012, primarily due to lower sales to the United States, partially offset by increased sales to Europe.

Costs and expenses for the Restricted Group in the first quarter of 2013 decreased by approximately 8% to 103.4 million from 112.5 million in the comparative period of 2012, primarily due to lower pulp sales volumes and fiber costs at our mills.

In the first quarter of 2013, operating depreciation and amortization for the Restricted Group was 8.2 million, compared to 7.6 million in the same quarter last year. Selling, general and administrative expenses for the Restricted Group were 5.7 million, compared to 6.5 million in the same period of 2012.

Transportation costs for the Restricted Group decreased to 11.6 million in the first quarter of 2013 from 12.9 million in the same quarter last year primarily due to lower pulp sales volumes.

Overall, per unit fiber costs of the Restricted Group in the first quarter of 2013 decreased by approximately 5%, compared to the same period in 2012. During the first quarter of 2013, fiber costs at our Rosenthal mill were marginally lower than the comparative period in 2012, when fiber prices were near record highs. Increased demand from the European pellet and board producers, reduced wood supply because of longer than normal winter weather conditions and lower availability of trucking transportation kept fiber prices at relatively high levels in the current quarter. Fiber costs at our Celgar mill decreased as a result of increased sawmill activity in the region. The recent extreme weather conditions are expected to put upward pressure on fiber costs at our Rosenthal mill in the short term, whereas, we expect fiber costs at our Celgar mill to continue to decrease in the short term.

In the first quarter of 2013, the Restricted Group reported operating income of 3.9 million, compared to 5.4 million in the first quarter of 2012, primarily due to the combined effect of lower pulp prices and pulp sales volumes.

Interest expense for the Restricted Group increased marginally to 5.9 million in the first quarter of 2013 from 5.8 million in the same quarter last year, primarily due to increased borrowings at the Celgar mill.

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

During the first quarter of 2013, the Restricted Group recorded 1.0 million of income tax expense, compared to income tax expense of 0.7 million in the same period last year.

The Restricted Group reported a net loss for the first quarter of 2013 of 1.8 million, compared to a net loss of 0.3 million in the same period last year.

In the first quarter of 2013, the Restricted Group reported Operating EBITDA of 12.2 million, compared to Operating EBITDA of 13.1 million in the comparative quarter of 2012. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our consolidated results for the three months ended March 31, 2013 for additional information relating to such limitations of Operating EBITDA.

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

	Three Months Ended March 31, 2013	2012
	(in thousands)	
Restricted Group[(1)]		
Net loss	(1,792)	(317)
Income tax provision (benefit)	1,016	715
Interest expense	5,866	5,810
Loss on derivative instruments	345	
Other expense (income)	(1,535)	(825)
Operating income	3,900	5,383
Add: Depreciation and amortization	8,254	7,703
Operating EBITDA	12,154	13,086

(1) See Note 11 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results.

Liquidity and Capital Resources of the Restricted Group

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

	As at March 31, 2013	As at December 31, 2012
	(in thousands)	
Restricted Group Financial Position[(1)]		
Cash and cash equivalents	52,032	36,714
Working capital	135,744	132,130
Total assets	661,657	644,119
Long-term liabilities	266,151	260,185
Total equity	330,177	335,353

(1) See Note 11 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results.

At March 31, 2013, cash and cash equivalents for the Restricted Group increased to 52.0 million from 36.7 million at the end of 2012.

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

Critical Accounting Policies

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

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

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

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

Cautionary Statement Regarding Forward-Looking Information

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

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

- the highly cyclical nature of our business;

- our level of indebtedness could negatively impact our financial condition and results of operations;

a weakening of the global economy could adversely affect our business and financial results and have a material adverse effect on our liquidity and capital resources;

cyclical fluctuations in the price and supply of our raw materials could adversely affect our business;

we operate in highly competitive markets;

we are exposed to currency exchange rate and interest rate fluctuations;

we use derivatives to manage certain risks which has caused significant fluctuations in our operating results;

we are subject to extensive environmental regulation and we could have environmental liabilities at our facilities;

our business is subject to risks associated with climate change and social government responses thereto;

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

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

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

Project Blue Mill might not generate the results we expect;

we are subject to risks related to our employees;

we rely on German federal and state government grants and guarantees and participate in European statutory programs;

we are dependent on key personnel;

we may experience material disruptions to our production;

if our long-lived assets become impaired, we may be required to record non-cash impairment that could have a material impact on our results of operations;

- we may incur losses as a result of unforeseen or catastrophic events, including the emergence of a pandemic, terrorist attacks or natural disasters;
- our insurance coverage may not be adequate;
- we rely on third parties for transportation services; and
- the price of our common stock may be volatile.

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

Cyclical Nature of Business

Revenues

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

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

Demand for pulp has historically been determined primarily by general global macro-economic conditions and has been closely tied to overall business activity. From 2006 to mid-2008, pulp prices steadily improved. However, the global economic crisis in the latter half of 2008 resulted in a sharp decline of pulp prices from a high of 900 per ADMT to 635 per ADMT at the end of 2008. Pulp prices began to increase in the second half of 2009 and continued to increase to record levels through June of 2010, before declining slightly in the fourth quarter of 2010. Pulp prices again rebounded to record levels in the first half of 2011 but declined sharply in the latter part of the year, primarily due to economic uncertainty in Europe and credit tightening in China. Economic uncertainty in Europe and China, respectively, impacted both demand and prices. In 2012, list prices were on average approximately 15% lower than 2011. Demand and pulp prices increased during the first quarter of 2013, and as at March 31, 2013, list prices for NBSK pulp were approximately $840 in Europe, $900 in North America and $700 in China.

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

Costs

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

Currency

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

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

During the three months ended March 31, 2013, we recorded an unrealized gain of approximately 5.1 million on our outstanding interest rate derivative, compared to 0.9 million in the same period of 2012.

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

We recorded a loss of approximately 0.3 million related to these swap contracts in the three months ended March 31, 2013.

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

ITEM 4. CONTROLS AND PROCEDURES
Disclosure Controls and Procedures

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

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

Changes in Internal Controls

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

Other than as listed above, there have been no material changes to the factors disclosed in Item 1A. Risk Factors in our latest annual report on Form 10-K for the fiscal year ended December 31, 2012.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit No.	Description
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1*	Section 906 Certification of Chief Executive Officer
32.2*	Section 906 Certification of Chief Financial Officer
101	The following financial statements from the Company s Form 10-Q for the fiscal quarter ended March 31, 2013, formatted in XBRL: (i) Interim Consolidated Balance Sheets; (ii) Interim Consolidated Statements of Operations; (iii) Interim Consolidated Statements of Retained Earnings; (iv) Interim Consolidated Statements of Comprehensive Income; (v) Interim Consolidated Statements of Cash Flows; and (vi) Notes to Interim Consolidated Financial Statements.

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

SIGNATURES

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

MERCER INTERNATIONAL INC.

By: /s/ David M. Gandossi
David M. Gandossi

Secretary and Chief Financial Officer

Date: May 3, 2013