MERCER INTERNATIONAL INC.
Form 10-Q
November 02, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

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 incorporation or organization)	**(I.R.S. Employer 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 November 1, 2012.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012

(Unaudited)

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands of Euros)

	September 30, 2012	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	126,169	105,072
Marketable securities		12,216
Receivables	118,631	120,487
Inventories (Note 2)	113,355	120,539
Prepaid expenses and other	10,203	8,162
Deferred income tax	9,036	6,750
Total current assets	377,394	373,226
Long-term assets		
Property, plant and equipment	815,661	820,974
Deferred note issuance and other	11,924	10,763
Deferred income tax	15,760	12,287
	843,345	844,024
Total assets	1,220,739	1,217,250
LIABILITIES		
Current liabilities		
Accounts payable and other	115,037	99,640
Pension and other post-retirement benefit obligations (Note 4)	789	756
Debt (Note 3)	41,088	25,671
Total current liabilities	156,914	126,067
Long-term liabilities		
Debt (Note 3)	670,792	708,415
Unrealized interest rate derivative losses (Note 8)	53,027	52,391
Pension and other post-retirement benefit obligations (Note 4)	32,388	31,197
Capital leases and other	13,399	13,053
Deferred income tax	5,435	2,585
	775,041	807,641
Total liabilities	931,955	933,708
EQUITY		
Shareholders equity		
Share capital (Note 5)	248,371	247,642
Paid-in capital	(3,954)	(4,857)
Retained earnings	30,961	37,985
Accumulated other comprehensive income	29,115	21,346

Total shareholders equity	304,493	302,116
Noncontrolling deficit	(15,709)	(18,574)
Total equity	288,784	283,542
Total liabilities and equity	1,220,739	1,217,250

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 September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Revenues				
Pulp	205,122	190,426	590,597	618,158
Energy and chemicals	18,153	16,639	55,098	49,732
	223,275	207,065	645,695	667,890
Costs and expenses				
Operating costs	191,083	149,172	531,470	490,537
Operating depreciation and amortization	14,972	13,832	43,784	41,777
	17,220	44,061	70,441	135,576
Selling, general and administrative expenses	10,006	8,754	28,688	27,414
Operating income	7,214	35,307	41,753	108,162
Other income (expense)				
Interest expense	(14,084)	(14,117)	(42,080)	(44,906)
Gain (loss) on derivative instruments (Note 8)	(883)	(10,484)	1,336	(580)
Foreign exchange gain (loss) on debt		(181)		1,272
Other income (expense)	517	201	(261)	664
Total other income (expense)	(14,450)	(24,581)	(41,005)	(43,550)
Income (loss) before income taxes	(7,236)	10,726	748	64,612
Income tax benefit (provision)				
Current	(870)	(1,557)	(7,207)	(3,854)
Deferred	(1,040)	(1,567)	2,300	(3,707)
Net income (loss)	(9,146)	7,602	(4,159)	57,051
Less: net loss (income) attributable to noncontrolling interest	(566)	838	(2,865)	(5,175)
Net income (loss) attributable to common shareholders	(9,712)	8,440	(7,024)	51,876
Net income (loss) per share attributable to common shareholders (Note 7)				
Basic	(0.17)	0.15	(0.13)	1.07
Diluted	(0.17)	0.15	(0.13)	0.92

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

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

(Unaudited)

(In thousands of Euros)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Net income (loss) attributable to common shareholders	(9,712)	8,440	(7,024)	51,876
Retained earnings (deficit), beginning of period	40,673	32,480	37,985	(10,956)
	30,961	40,920	30,961	40,920
Retirement of treasury shares		(1,134)		(1,134)
Retained earnings, end of period	30,961	39,786	30,961	39,786

INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands of Euros)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Net income (loss)	(9,146)	7,602	(4,159)	57,051
Other comprehensive income (loss), net of taxes				
Foreign currency translation adjustment during the three and nine month periods, net of tax provision of 328 and tax benefit of 197, respectively (2011 benefit of 1,559 and provision of 90)	7,582	(12,913)	8,395	(10,313)
Pension income (expense)	(327)	(20)	(663)	383
Unrealized gains (losses) on securities arising during the period	35	(20)	37	(20)
Other comprehensive income (loss), net of taxes	7,290	(12,953)	7,769	(9,950)
Total comprehensive income (loss)	(1,856)	(5,351)	3,610	47,101
Comprehensive loss (income) attributable to noncontrolling interest	(566)	838	(2,865)	(5,175)
Comprehensive income (loss) attributable to common shareholders	(2,422)	(4,513)	745	41,926

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 September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Cash flows from (used in) operating activities				
Net income (loss) attributable to common shareholders	(9,712)	8,440	(7,024)	51,876
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities				
Loss (gain) on derivative instruments	883	10,484	(1,336)	580
Foreign exchange loss (gain) on debt		181		(1,272)
Depreciation and amortization	15,054	13,893	43,992	41,960
Noncontrolling interest	566	(838)	2,865	5,175
Deferred income taxes	1,040	1,567	(2,300)	3,707
Stock compensation expense	891	305	1,753	2,844
Pension and other post-retirement expense, net of funding	(73)	(95)	(128)	(102)
Other	1,412	260	2,278	2,622
Changes in current assets and liabilities				
Receivables	(14,122)	(9,452)	901	3,248
Inventories	5,834	(23,776)	9,276	(27,862)
Accounts payable and accrued expenses	9,692	318	13,146	24,873
Other	(2,239)	(752)	(901)	92
Net cash from (used in) operating activities	9,226	535	62,522	107,741
Cash flows from (used in) investing activities				
Purchase of property, plant and equipment	(9,152)	(10,297)	(27,455)	(26,122)
Proceeds on sale of property, plant and equipment	48	1,564	387	1,944
Purchase of marketable securities		(4,018)		(4,018)
Proceeds on maturity of marketable securities	10,213		12,221	
Note receivable		2,064		2,835
Net cash from (used in) investing activities	1,109	(10,687)	(14,847)	(25,361)
Cash flows from (used in) financing activities				
Repayment of notes payable and debt	(15,544)	(12,160)	(27,254)	(42,511)
Repayment of capital lease obligations	(508)	(776)	(1,567)	(2,269)
Repayment of credit facilities, net				(14,652)
Payment of note issuance costs			(1,621)	
Proceeds from government grants	778	4,470	3,100	13,419
Purchase of treasury shares		(7,477)		(7,477)
Net cash from (used in) financing activities	(15,274)	(15,943)	(27,342)	(53,490)
Effect of exchange rate changes on cash and cash equivalents	221	2,058	764	(154)
Net increase (decrease) in cash and cash equivalents	(4,718)	(24,037)	21,097	28,736
Cash and cash equivalents, beginning of period	130,887	151,795	105,072	99,022
Cash and cash equivalents, end of period	126,169	127,758	126,169	127,758

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

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Unaudited)

(In thousands of Euros)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Supplemental disclosure of cash flow information				
Cash paid during the period for				
Interest	3,820	5,822	30,086	35,742
Income taxes	370	1,389	3,389	1,725
Supplemental schedule of non-cash investing and financing activities				
Acquisition of production and other equipment under capital lease obligations	(186)	973	588	1,246
Increase (decrease) in accrued purchases of property, plant and equipment	1,472	(1,708)	3,375	1,778
Increase (decrease) in receivables of government grants for long-term assets	(200)	(3,238)	(2,533)	(6,128)

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, 2011. In the opinion of the Company, the unaudited interim consolidated financial statements contained herein contain all adjustments necessary to fairly present the results of the interim periods included. The results for the periods included herein may not be indicative of the results for the entire year.

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

Certain prior year amounts in the interim consolidated financial statements have been reclassified to conform to the current year presentation. 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 and nine month periods ended September 30, 2012 was 2,936 and 8,923, respectively (2011 2,287 and 7,762).

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

Use of Estimates

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

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

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

Recently Implemented Accounting Standards

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2011-04, *Fair Value Measurements* (ASU 2011-04), which expands the existing disclosure requirements for fair value measurements (particularly for Level 3 inputs) defined under FASB s Accounting Standards Codification No. 820, *Fair Value Measurement* (ASC 820), and makes other amendments. Many of the amendments to ASC 820 are being made to eliminate wording differences between GAAP and International Financial Reporting Standards and are not intended to result in a change in the application of the requirements of ASC 820. However, some of the amendments clarify the application of existing fair value measurement requirements and others change certain requirements for measuring fair value and could change how the fair value measurement guidance in ASC 820 is applied. The measurement and disclosure requirements of ASU 2011-04 were effective for reporting periods beginning after December 15, 2011 and were applied prospectively. The adoption of this new guidance did not have an impact on the interim consolidated financial statements or related note disclosures.

In June 2011, FASB issued Accounting Standards Update 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05), which revises the manner in which entities present comprehensive income in their financial statements. The new guidance amends FASB s Accounting Standards Codification No. 220, *Comprehensive Income* (ASC 220), and gives reporting entities the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. Under the two-statement approach, which the Company currently uses, the first statement includes components of net income, and the second statement includes components of other comprehensive income. ASU 2011-05 does not change the items that must be reported in other comprehensive income. This new guidance was effective for reporting periods beginning after December 15, 2011 and was applied retrospectively. The adoption of this guidance did not have an impact on the interim consolidated financial statements or related note disclosures.

Note 2. Inventories

	September 30, 2012	**December 31, 2011**
Raw materials	46,562	48,063
Finished goods	30,768	41,392
Spare parts, work in process and other	36,025	31,084
	113,355	120,539

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 3. Debt

Debt consists of the following:

	September 30, 2012	December 31, 2011
Note payable to bank, included in a total loan credit facility of 827,950 to finance the construction related to the Stendal mill (a)	452,907	477,490
Senior notes, interest at 9.50% accrued and payable semi-annually, unsecured (b)	221,189	220,753
Credit agreement with a lender with respect to a revolving credit facility of C$40 million (c)		
Term bank facility for a project at the Stendal mill of 17,000 (d)		
Loans payable to the noncontrolling shareholder of the Stendal mill (e)	36,152	33,124
Investment loan agreement with a lender with respect to a project at the Rosenthal mill of 4,351 (f)	1,632	2,719
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)		
	711,880	734,086
Less: current portion	(41,088)	(25,671)
Debt, less current portion	670,792	708,415

The Company made principal repayments under these facilities of 27,254 during the nine month period ended September 30, 2012 (2011 42,511). As of September 30, 2012, the principal maturities of debt are as follows:

Matures	Amount
2012	
2013	41,088
2014	40,544
2015	44,000
2016	44,000
Thereafter	542,248
	711,880

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 other important qualifications and exceptions. As at September 30, 2012, the Company was in compliance with the terms of the indenture.

FORM 10-Q

QUARTERLY REPORT - PAGE 10

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 3. Debt (continued)

(a) Note payable to bank, included in a total loan facility of 827,950 to finance the construction related to the Stendal mill (Stendal Loan Facility), interest at rates varying from Euribor plus 0.90% to Euribor plus 1.80% (rates on amounts of borrowing at September 30, 2012 range from 1.50% to 2.25%), principal due in required installments beginning September 30, 2006 until September 30, 2017, collateralized by the assets of the Stendal mill, with 48% and 32% guaranteed by the Federal Republic of Germany and the State of Saxony-Anhalt, respectively, of up to 392,907 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 September 30, 2012, the DSRA balance was 31,821 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 August 2011, the Company s Board of Directors authorized the purchase of up to $25.0 million in aggregate principal amount of the Company s Senior Notes from time to time, over a period ending August 2012. 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 nine month period ended September 30, 2012, the Company purchased $2.0 million of its outstanding Senior Notes. During the twelve month period ended December 31, 2011, the Company purchased $13.6 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 agreement matures May 2013. Borrowings under the credit agreement are collateralized by the mill s inventory and receivables and are restricted by a borrowing base calculated on the mill s inventory and receivables. Canadian dollar denominated amounts bear interest at bankers acceptance plus 3.75% or Canadian prime plus 2.00%. U.S. dollar denominated amounts bear interest at LIBOR plus 3.75% or U.S. base plus 2.00%. As at September 30, 2012, approximately C$36.3 million was available.

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 , 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 and will be non-recourse to the Company. As at September 30, 2012, the Company had not drawn on this facility. 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 September 30, 2012 the balance in the investment account was 7,087; this cash was from shareholder loans entered into in January 2012 and operating cash flows.

(e) A loan of 25,128 payable by the Stendal mill to its noncontrolling shareholder bears interest at 7.00%, and is accrued semi-annually. The loan payable is unsecured, subordinated to all liabilities of the Stendal mill, non-recourse to the Company and its restricted subsidiaries, and is due in 2017.

In January 2012, the Stendal mill entered into two additional loans payable by the Stendal mill to its noncontrolling shareholder as part of the financing for Project Blue Mill. The first loan has a principal amount of 1,192 and the second loan has a principal amount of 440. Both loans bear interest at 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 second loan may be repaid prior to October 1, 2017 if the DSRA has been Fully Funded for the first time. The first loan is subordinated to all liabilities of the Stendal mill and the second loan is subordinated to all liabilities of the Stendal mill only until such time as the DSRA is Fully Funded for the first time.

As at September 30, 2012, accrued interest on these loans was 9,392. As at December 31, 2011, accrued interest on the loan was 7,996.

(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 new wash press equipment. As at September 30, 2012, the balance outstanding was 1,632 and was accruing interest at a rate of 3.42%.

(g) A 25,000 working capital facility at the Rosenthal mill that matures in December 2012. Borrowings under the facility are collateralized by the mill s inventory and receivables and bear interest at Euribor plus 3.50%. As at September 30, 2012, approximately 2,100 of this facility was supporting bank guarantees leaving approximately 22,900 available. In October 2012, the facility maturity date was extended to October 31, 2016 under the same terms and conditions.

(h) On February 8, 2010, the Rosenthal mill finalized a credit agreement with a lender for a 3,500 facility maturing in December 2012. Borrowings under this facility bear interest at the rate of the three-month Euribor plus 3.50% and are secured by certain land at the Rosenthal mill. As at September 30, 2012, this facility was undrawn and negotiations to extend the terms of the facility are underway.

FORM 10-Q

QUARTERLY REPORT - PAGE 12

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 4. Pension and Other Post-Retirement Benefit Obligations

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

Pension benefits are based on employees earnings and years of service. The Celgar Plans are funded by contributions from the Company based on actuarial estimates and statutory requirements. Pension contributions during the three and nine month periods ended September 30, 2012 totaled 481 and 1,493, respectively (2011 534 and 1,429).

Effective December 31, 2008, the defined benefit plan was closed to new members. In addition, the defined benefit service accrual ceased on December 31, 2008, and members began to receive pension benefits, at a fixed contractual rate, under a new defined contribution plan effective January 1, 2009. During the three and nine month periods ended September 30, 2012, the Company made contributions of 142 and 462, respectively (2011 141 and 426) to this plan.

Information about the Celgar Plans, in aggregate for the three and nine month periods ended September 30, 2012 and September 30, 2011 is as follows:

	Three Months ended September 30,			
	2012		2011	
	Pension Benefits	Post-Retirement Benefits	Pension Benefits	Post-Retirement Benefits
Service cost	29	145	22	117
Interest cost	393	226	376	203
Expected return on plan assets	(421)		(385)	
Recognized net loss (gain)	291	1	127	(17)
Net periodic benefit cost	292	372	140	303

	Nine Months ended September 30,			
	2012		2011	
	Pension Benefits	Post-Retirement Benefits	Pension Benefits	Post-Retirement Benefits
Service cost	84	423	65	352
Interest cost	1,144	657	1,134	612
Expected return on plan assets	(1,228)		(1,163)	
Recognized net loss (gain)	848	4	383	(52)
Net periodic benefit cost	848	1,084	419	912

The Company participates in a multiemployer plan for hourly-paid employees at the Celgar mill. The contributions to this plan are determined based on an amount per hour worked pursuant to a collective bargaining agreement. The Company has no current or future contribution obligations in excess of the contractual contributions. During the three and nine month periods ended September 30, 2012, the Company made contributions of 632 and 1,572, respectively (2011 455 and 1,429) to this plan.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 5. Share Capital

Common shares

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

As at September 30, 2012, the Company had 55,815,704 common shares issued and outstanding. As at December 31, 2011, the Company had 55,779,204 common shares issued and outstanding. During the nine months ended September 30, 2012, the Company issued 36,500 restricted shares to directors of the Company.

Share Repurchase Program

In August 2011, the Company s Board of Directors authorized a share repurchase program (the Program) to repurchase up to $25.0 million worth of the Company s outstanding common shares from time to time over a period ending August 2012. In July 2012, the Company s Board of Directors re-authorized the Program to allow for the repurchase of up to approximately $14.4 million of the Company s outstanding shares of common stock over a period ending August 2013. During the nine month period ended September 30, 2012, the Company did not repurchase any of its common shares. During the twelve month period ended December 31, 2011, the Company repurchased 1,263,401 of its common shares at an aggregate cost of $10.6 million.

Preferred shares

The Company has authorized 50,000,000 preferred shares with $1 par value issuable in series, of which 2,000,000 shares have been designated as Series A. The preferred shares may be issued in one or more series and with such designations and preferences for each series as shall be stated in the resolutions providing for the designation and issue of each such series adopted by the Board of Directors of the Company. The Board of Directors is authorized by the Company s articles of incorporation to determine the voting, dividend, redemption and liquidation preferences pertaining to each such series. As at September 30, 2012, no preferred shares had been issued by the Company.

Note 6. Stock-Based Compensation

In June 2010, the Company adopted a new stock incentive plan (the 2010 Plan) which provides for options, restricted stock rights, restricted shares, performance shares, performance share units (PSUs) and stock appreciation rights to be awarded to employees, consultants and non-employee directors. As at September 30, 2012, after factoring in all allocated shares, there remain approximately 1.1 million common shares available for grant pursuant to the 2010 Plan.

Performance Shares and PSUs

Performance shares are common shares granted to an employee which have restrictive conditions, such as the ability to sell the shares, until the Company and the grantee achieve certain performance objectives. PSUs comprise rights to receive common shares at a future date that are contingent on the Company and the grantee achieving certain performance objectives.

The fair value of the performance shares and PSUs is recorded as compensation expense over the vesting period. The fair value is determined based upon the targeted number of shares awarded and the quoted price of the Company s shares at the reporting date. The target number of shares is determined using management s best estimate. The final determination of the number of shares to be granted or unrestricted will be made by the Company s Board of Directors. For the three and nine month periods ended September 30, 2012 the Company recognized an expense of 714 and 1,091, respectively, related to the PSUs (2011 expense 13 and 771).

As at September 30, 2012, there are no performance shares outstanding.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 6. Stock-Based Compensation (continued)

The following table summarizes PSU activity during the period:

	Number of PSUs
Outstanding at January 1, 2011	534,783
Granted	812,575
Vested and issued	(474,728)
Cancelled	(60,055)
Forfeited	(17,263)
Outstanding at December 31, 2011	795,312
Granted	37,328
Forfeited	(64,661)
Outstanding at September 30, 2012	767,979

Restricted Shares

The fair value of restricted shares is determined based upon the number of shares granted and the quoted price of the Company s shares on the date of grant. Restricted shares generally vest over one year; however, 200,000 restricted shares granted during the year ended December 31, 2011 vest in equal amounts over a five-year period commencing in 2012. The fair value of the restricted shares is recorded as compensation expense on a straight-line basis over the vesting period.

For the three and nine month periods ended September 30, 2012, the Company recognized an expense of 177 and 662, respectively (2011 295 and 691) related to the restricted shares. As at September 30, 2012, the total remaining unrecognized compensation cost related to restricted shares amounted to approximately 901 (2011 1,642), which will be amortized over the remaining vesting periods.

The following table summarizes restricted share activity during the period:

	Number of restricted shares
Outstanding at January 1, 2011	56,000
Granted	238,000
Vested	(56,000)
Outstanding at December 31, 2011	238,000
Granted	36,500
Vested	(78,000)

Outstanding at September 30, 2012	196,500

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 6. Stock-Based Compensation (continued)

Stock Options

During the nine month periods ended September 30, 2012 and 2011, no options were granted, exercised or cancelled. During the nine month period ended September 30, 2012, no options expired (2011 15,000). The aggregate intrinsic value of options is calculated as the difference between the quoted market price for the Company s common stock as at September 30, 2012, and the exercise price of the stock options for those options where the exercise price is below the quoted market price. As at September 30, 2012, the Company had 130,000 options (2011 100,000) with an exercise price below the quoted market price resulting in an aggregate intrinsic value of 145 (2011 - 82). The Company issues new shares upon the exercise of stock options.

Stock option expense recognized for the three and nine month periods ended September 30, 2012 was nil (2011 nil). As at September 30, 2012 the Company had 175,000 stock options which have fully vested.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income (loss) attributable to common shareholders basic	(9,712)	8,440	(7,024)	51,876
Interest on convertible notes, net of tax		40		789
Net income (loss) attributable to common shareholders diluted	(9,712)	8,480	(7,024)	52,665
Net income (loss) per share attributable to common shareholders				
Basic	(0.17)	0.15	(0.13)	1.07
Diluted	(0.17)	0.15	(0.13)	0.92
Weighted average number of common shares outstanding:				
Basic[(1)]	55,619,204	55,141,780	55,589,226	48,289,039
Effect of dilutive instruments:				
Performance shares and PSUs		158,023		543,383
Restricted shares				65,917
Stock options and awards		46,953		69,602
Convertible notes		1,219,468		8,260,848
Diluted	55,619,204	56,566,224	55,589,226	57,228,789

(1) The basic weighted average number of shares excludes 196,500 restricted shares which have been issued, but have not vested as at September 30, 2012 (2011 238,000 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 earnings per share. The following table summarizes the instruments excluded from the calculation of net income (loss) per share attributable to common shareholders because they were anti-dilutive.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
PSUs	767,979		767,979	
Restricted shares	196,500	238,000	196,500	
Stock options and awards	175,000		175,000	

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 the Interim Consolidated Statement of Operations.

Interest Rate Derivative

During 2004, the Company entered into certain variable-to-fixed interest rate swaps in connection with the Stendal Loan Facility with respect to an aggregate maximum principal amount of approximately 612,600 of the principal of the total 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 381,489 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. With respect to this interest rate swap for the three and nine month periods ended September 30, 2012, the Company recognized unrealized losses of 1,236 and 636, respectively (2011 losses of 10,484 and 580), in gain (loss) on derivative instruments in the Interim Consolidated Statement of Operations. The fair value of the interest rate swap is presented in unrealized interest rate derivative losses in the Interim Consolidated Balance Sheet, which currently amounts to a cumulative unrealized loss of 53,027. As at December 31, 2011 the unrealized interest rate derivative loss was 52,391.

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

Pulp Price Derivative

During May 2012, the Company entered into a fixed price pulp swap contract with a bank. Under the contract, 5,000 metric tonnes (MT) of pulp per month is fixed at a price of $915 per MT. The contract expires in December 2012. With respect to this contract for the three and nine month periods ended September 30, 2012, the Company recognized gains of 353 and 1,972, respectively in gain (loss) on derivative instruments in the Interim Consolidated Statement of Operations. The fair value of the fixed price pulp swap contract was 1,462 as at September 30, 2012 and was presented in prepaid expenses and other in the Interim Consolidated Balance Sheet.

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:

	September 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	126,169	126,169	105,072	105,072
Marketable securities[(1)]	190	190	12,372	12,372
Receivables	118,631	118,631	120,487	120,487
Pulp price derivative contract asset	1,462	1,462		
Accounts payable and other	115,037	115,037	99,640	99,640
Debt	711,880	703,864	734,086	717,522
Interest rate derivative contract liability	53,027	53,027	52,391	52,391

(1) Includes equity securities of 190 (2011 156) recorded in the Interim Consolidated Balance Sheet within deferred note issuance and other.
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 contract and interest rate derivative contract was determined.

Many of the Company s transactions are denominated in foreign currencies, primarily the U.S. dollar. As a result of these transactions, the Company and its subsidiaries have financial risk that the value of the Company s financial instruments will vary due to fluctuations in foreign exchange rates.

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 both exchange-traded equities and the German federal government bonds.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 9. Financial Instruments (continued)

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

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

	Fair value measurements at September 30, 2012 using:			
Description	(Level 1)	(Level 2)	(Level 3)	Total
Assets				
Marketable securities				
Exchange traded equities	190			190
Derivative fixed price pulp swaps		1,462		1,462
	190	1,462		1,652
Liabilities				
Derivative interest rate swap		53,027		53,027

	Fair value measurements at December 31, 2011 using:			
Description	(Level 1)	(Level 2)	(Level 3)	Total
Assets				
Marketable securities				
German federal government bonds	12,216			12,216
Exchange traded equities	156			156
	12,372			12,372
Liabilities				
Derivative interest rate swap		52,391		52,391

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 10. Commitments and Contingencies

(a) Pursuant to an arbitration proceeding with the general construction contractor 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 is less than the amount claimed by the Company under the arbitration. Consequently, the arbitration proceeding is ongoing, and there is no certainty that the Company will be successful with its claims.

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 general construction contractor an agreed-to portion of the payable is reversed with the offset recorded in operating costs to offset the remediation expenditures. In January 2012, the noncontrolling shareholder contributed its required 1,632 from the Guarantee Amount as part of the financing agreement for Project Blue Mill. This contribution was reclassified to long-term debt as part of the loan payable to the noncontrolling shareholder. See Note 3(e) Debt. As at September 30, 2012, the Company had Guarantee Amount proceeds of 3,769 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, and the court date is scheduled during the first quarter of 2013 to appeal the assessment. While the outcome of these legal actions and claims cannot be predicted with certainty, it is the opinion of management that the outcome of any such claim which is pending or threatened, either individually or on a combined basis, will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company.

(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 September 30, 2012, the Company had entered into capital commitments of approximately 17,100 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 and nine months ended September 30, 2012 and 2011, the Restricted Group was comprised of Mercer International Inc., certain holding subsidiaries and our Rosenthal and Celgar mills. The Restricted Group excludes the Stendal mill.

Combined Condensed Balance Sheets

	September 30, 2012			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
ASSETS				
Current assets				
Cash and cash equivalents	55,023	71,146		126,169
Receivables	62,313	56,318		118,631
Inventories	69,838	43,517		113,355
Prepaid expenses and other	7,730	2,473		10,203
Deferred income tax	5,301	3,735		9,036
Total current assets	200,205	177,189		377,394
Long-term assets				
Property, plant and equipment	356,302	459,359		815,661
Deferred note issuance and other	6,077	5,847		11,924
Deferred income tax	8,873	6,887		15,760
Due from unrestricted group	99,991		(99,991)	
Total assets	671,448	649,282	(99,991)	1,220,739
LIABILITIES				
Current liabilities				
Accounts payable and other	62,674	52,363		115,037
Pension and other post-retirement benefit obligations	789			789
Debt	1,088	40,000		41,088
Total current liabilities	64,551	92,363		156,914
Long-term liabilities				
Debt	221,733	449,059		670,792
Due to restricted group		99,991	(99,991)	
Unrealized interest rate derivative losses		53,027		53,027
Pension and other post-retirement benefit obligations	32,388			32,388
Capital leases and other	6,367	7,032		13,399
Deferred income tax	5,435			5,435
Total liabilities	330,474	701,472	(99,991)	931,955

EQUITY				
Total shareholders equity (deficit)	340,974	(36,481)		304,493
Noncontrolling deficit		(15,709)		(15,709)
Total liabilities and equity	671,448	649,282	(99,991)	1,220,739

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, 2011			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
ASSETS				
Current assets				
Cash and cash equivalents	44,829	60,243		105,072
Marketable securities	12,216			12,216
Receivables	62,697	57,790		120,487
Inventories	71,692	48,847		120,539
Prepaid expenses and other	5,019	3,143		8,162
Deferred income tax	5,179	1,571		6,750
Total current assets	201,632	171,594		373,226
Long-term assets				
Property, plant and equipment	353,925	467,049		820,974
Deferred note issuance and other	5,971	4,792		10,763
Deferred income tax	8,492	3,795		12,287
Due from unrestricted group	88,824		(88,824)	
Total assets	658,844	647,230	(88,824)	1,217,250
LIABILITIES				
Current liabilities				
Accounts payable and other	49,815	49,825		99,640
Pension and other post-retirement benefit obligations	756			756
Debt	1,088	24,583		25,671
Total current liabilities	51,659	74,408		126,067
Long-term liabilities				
Debt	222,384	486,031		708,415
Due to restricted group		88,824	(88,824)	
Unrealized interest rate derivative losses		52,391		52,391
Pension and other post-retirement benefit obligations	31,197			31,197
Capital leases and other	6,604	6,449		13,053
Deferred income tax	2,585			2,585
Total liabilities	314,429	708,103	(88,824)	933,708
EQUITY				

Total shareholders equity (deficit)	344,415	(42,299)		302,116
Noncontrolling deficit		(18,574)		(18,574)
Total liabilities and equity	658,844	647,230	(88,824)	1,217,250

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

	Three Months Ended September 30, 2011			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	111,634	78,792		190,426
Energy and chemicals	6,121	10,518		16,639

	117,755	89,310		207,065
Operating costs	85,962	63,210		149,172
Operating depreciation and amortization	7,364	6,468		13,832
Selling, general and administrative expenses	6,080	2,674		8,754
	99,406	72,352		171,758
Operating income	18,349	16,958		35,307
Other income (expense)				
Interest expense	(5,496)	(9,869)	1,248	(14,117)
Gain (loss) on derivative instruments		(10,484)		(10,484)
Foreign exchange loss on debt	(181)			(181)
Other income (expense)	1,265	184	(1,248)	201
Total other income (expense)	(4,412)	(20,169)		(24,581)
Income (loss) before income taxes	13,937	(3,211)		10,726
Income tax provision	(2,566)	(558)		(3,124)
Net income (loss)	11,371	(3,769)		7,602
Less: net loss attributable to noncontrolling interest		838		838
Net income (loss) attributable to common shareholders	11,371	(2,931)		8,440

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

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

	Nine Months Ended September 30, 2011			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	352,098	266,060		618,158
Energy and chemicals	17,668	32,064		49,732

	369,766	298,124		667,890
Operating costs	272,162	218,375		490,537
Operating depreciation and amortization	22,379	19,398		41,777
Selling, general and administrative expenses	17,572	9,842		27,414
	312,113	247,615		559,728
Operating income	57,653	50,509		108,162
Other income (expense)				
Interest expense	(19,202)	(29,404)	3,700	(44,906)
Gain (loss) on derivative instruments		(580)		(580)
Foreign exchange gain on debt	1,272			1,272
Other income (expense)	3,849	515	(3,700)	664
Total other income (expense)	(14,081)	(29,469)		(43,550)
Income (loss) before income taxes	43,572	21,040		64,612
Income tax provision	(5,941)	(1,620)		(7,561)
Net income (loss)	37,631	19,420		57,051
Less: net income attributable to noncontrolling interest		(5,175)		(5,175)
Net income (loss) attributable to common shareholders	37,631	14,245		51,876

FORM 10-Q

QUARTERLY REPORT - PAGE 24

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 September 30, 2012		
	Restricted Group	Unrestricted Subsidiaries	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss) attributable to common shareholders	(9,957)	245	(9,712)
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities			
Loss (gain) on derivative instruments	(353)	1,236	883
Depreciation and amortization	8,385	6,669	15,054
Noncontrolling interest		566	566
Deferred income taxes	1,040		1,040
Stock compensation expense	891		891
Pension and other post-retirement expense, net of funding	(73)		(73)
Other	543	869	1,412
Changes in current assets and liabilities			
Receivables	(6,130)	(7,992)	(14,122)
Inventories	1,693	4,141	5,834
Accounts payable and accrued expenses	9,800	(108)	9,692
Other[(1)]	(4,225)	1,986	(2,239)
Net cash from (used in) operating activities	1,614	7,612	9,226
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(6,380)	(2,772)	(9,152)
Proceeds on sale of property, plant and equipment	37	11	48
Proceeds on maturity of marketable securities	10,213		10,213
Net cash from (used in) investing activities	3,870	(2,761)	1,109
Cash flows from (used in) financing activities			
Repayment of notes payable and debt	(544)	(15,000)	(15,544)
Repayment of capital lease obligations	(234)	(274)	(508)
Proceeds from government grants		778	778
Net cash from (used in) financing activities	(778)	(14,496)	(15,274)
Effect of exchange rate changes on cash and cash equivalents	221		221
Net increase (decrease) in cash and cash equivalents	4,927	(9,645)	(4,718)

Cash and cash equivalents, beginning of period	50,096	80,791	130,887
Cash and cash equivalents, end of period	55,023	71,146	126,169

(1) Includes intercompany working capital 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 September 30, 2011		
	Restricted Group	Unrestricted Subsidiaries	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss) attributable to common shareholders	11,371	(2,931)	8,440
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities			
Loss (gain) on derivative instruments		10,484	10,484
Foreign exchange loss on debt	181		181
Depreciation and amortization	7,425	6,468	13,893
Noncontrolling interest		(838)	(838)
Deferred income taxes	1,567		1,567
Stock compensation expense	305		305
Pension and other post-retirement expense, net of funding	(95)		(95)
Other	110	150	260
Changes in current assets and liabilities			
Receivables	(12,224)	2,772	(9,452)
Inventories	(14,899)	(8,877)	(23,776)
Accounts payable and accrued expenses	(1,704)	2,022	318
Other[(1)]	(4,020)	3,268	(752)
Net cash from (used in) operating activities	(11,983)	12,518	535
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(7,859)	(2,438)	(10,297)
Proceeds on sale of property, plant and equipment	76	1,488	1,564
Purchase of marketable securities	(4,018)		(4,018)
Note receivable	2,064		2,064
Net cash from (used in) investing activities	(9,737)	(950)	(10,687)
Cash flows from (used in) financing activities			
Repayment of notes payable and debt	(3,576)	(8,584)	(12,160)
Repayment of capital lease obligations	(270)	(506)	(776)
Proceeds from government grants	4,470		4,470
Purchase of treasury shares	(7,477)		(7,477)
Net cash from (used in) financing activities	(6,853)	(9,090)	(15,943)

Effect of exchange rate changes on cash and cash equivalents	2,058		2,058
Net increase (decrease) in cash and cash equivalents	(26,515)	2,478	(24,037)
Cash and cash equivalents, beginning of period	86,941	64,854	151,795
Cash and cash equivalents, end of period	60,426	67,332	127,758

(1) Includes intercompany working capital 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

	Nine months ended September 30, 2012		
	Restricted Group	**Unrestricted Subsidiaries**	**Consolidated Group**
Cash flows from (used in) operating activities			
Net income (loss) attributable to common shareholders	(12,842)	5,818	(7,024)
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities			
Loss (gain) on derivative instruments	(1,972)	636	(1,336)
Depreciation and amortization	23,958	20,034	43,992
Noncontrolling interest		2,865	2,865
Deferred income taxes	2,956	(5,256)	(2,300)
Stock compensation expense	1,753		1,753
Pension and other post-retirement expense, net of funding	(128)		(128)
Other	66	2,212	2,278
Changes in current assets and liabilities			
Receivables	(407)	1,308	901
Inventories	3,946	5,330	9,276
Accounts payable and accrued expenses	12,180	966	13,146
Other[1]	(12,213)	11,312	(901)
Net cash from (used in) operating activities	17,297	45,225	62,522
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(19,413)	(8,042)	(27,455)
Proceeds on sale of property, plant and equipment	274	113	387
Proceeds on maturity of marketable securities	12,221		12,221
Net cash from (used in) investing activities	(6,918)	(7,929)	(14,847)
Cash flows from (used in) financing activities			
Repayment of notes payable and debt	(2,671)	(24,583)	(27,254)
Repayment of capital lease obligations	(600)	(967)	(1,567)
Payment of note issuance costs		(1,621)	(1,621)
Proceeds from government grants	2,322	778	3,100
Net cash from (used in) financing activities	(949)	(26,393)	(27,342)
Effect of exchange rate changes on cash and cash equivalents	764		764

Net increase (decrease) in cash and cash equivalents	10,194	10,903	21,097
Cash and cash equivalents, beginning of period	44,829	60,243	105,072
Cash and cash equivalents, end of period	55,023	71,146	126,169

(1) Includes intercompany working capital 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

	Nine months ended September 30, 2011		
	Restricted Group	Unrestricted Subsidiaries	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss) attributable to common shareholders	37,631	14,245	51,876
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities			
Loss (gain) on derivative instruments		580	580
Foreign exchange gain on debt	(1,272)		(1,272)
Depreciation and amortization	22,562	19,398	41,960
Noncontrolling interest		5,175	5,175
Deferred income taxes	3,707		3,707
Stock compensation expense	2,844		2,844
Pension and other post-retirement expense, net of funding	(102)		(102)
Other	1,234	1,388	2,622
Changes in current assets and liabilities			
Receivables	2,007	1,241	3,248
Inventories	(12,534)	(15,328)	(27,862)
Accounts payable and accrued expenses	11,979	12,894	24,873
Other(1)	(7,889)	7,981	92
Net cash from (used in) operating activities	60,167	47,574	107,741
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(19,860)	(6,262)	(26,122)
Proceeds on sale of property, plant and equipment	95	1,849	1,944
Purchase of marketable securities	(4,018)		(4,018)
Note receivable	2,835		2,835
Net cash from (used in) investing activities	(20,948)	(4,413)	(25,361)
Cash flows from (used in) financing activities			
Repayment of notes payable and debt	(19,344)	(23,167)	(42,511)
Repayment of capital lease obligations	(1,131)	(1,138)	(2,269)
Repayment of credit facilities, net	(14,652)		(14,652)
Proceeds from government grants	13,311	108	13,419
Purchase of treasury shares	(7,477)		(7,477)
Net cash from (used in) financing activities	(29,293)	(24,197)	(53,490)

Effect of exchange rate changes on cash and cash equivalents	(154)		(154)
Net increase (decrease) in cash and cash equivalents	9,772	18,964	28,736
Cash and cash equivalents, beginning of period	50,654	48,368	99,022
Cash and cash equivalents, end of period	60,426	67,332	127,758

(1) Includes intercompany working capital 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 September 30, 2012, 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 (NBSK) pulp mills through our wholly owned subsidiaries, Rosenthal and Celgar, and our 74.9% owned subsidiary, Stendal, which have a consolidated annual production capacity of approximately 1.5 million ADMTs.

The following discussion and analysis of our results of operations and financial condition for the three and nine months ended September 30, 2012 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, 2011 filed with the Securities and Exchange Commission (the SEC).

Current Market Environment

During the three months ended September 30, 2012, NBSK pulp prices decreased due to global economic uncertainty and the traditionally low pulp demand of the summer period. We believe that the market is bottoming and we currently anticipate that NBSK pulp prices will begin to gradually increase in the medium term as a result of improving demand and the relatively low level of NBSK inventories globally.

Third Quarter Operational Snapshot

Selected production, sales and exchange rate data for the three and nine months ended September 30, 2012 and 2011 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Pulp production (000 ADMTs)	373.4	362.3	1,118.8	1,088.8
Scheduled production downtime (000 ADMTs)	10.2	8.3	32.8	24.5
Pulp sales (000 ADMTs)	404.3	321.3	1,138.3	1,027.9
Pulp revenues (in millions)	205.1	190.4	590.6	618.2
Average NBSK pulp list prices in Europe ($/ADMT)[1]	$ 777	$ 980	$ 817	$ 986
Average NBSK pulp list prices in Europe (/ADMT)	620	694	637	701
Average pulp sales realizations (/ADMT)[2]	501	584	512	592
Energy production (000 MWh)	436.5	402.5	1,298.2	1,230.9
Energy sales (000 MWh)	181.3	149.3	546.4	483.1
Energy revenue (in millions)	15.2	14.4	46.2	42.0
Average energy sales realizations (/MWh)	84	96	85	87
Chemical sales revenue (in millions)	2.9	2.3	8.9	7.8
Total energy and chemical sales revenue (in millions)	18.2	16.6	55.1	49.7
Average spot currency exchange rates				
/ $[3]	0.7999	0.7084	0.7807	0.7110
C$ / $[3]	0.9954	0.9803	1.0022	0.9778
C$ / [4]	1.2452	1.3835	1.2847	1.3752

(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 September 30, 2012 Compared to Three Months Ended September 30, 2011

Total revenues for the three months ended September 30, 2012 increased to 223.3 million ($279.6 million) from 207.1 million ($292.4 million) in the same period in 2011, due to higher pulp and energy sales volumes and a stronger U.S. dollar relative to the Euro, partially offset by lower average pulp realizations.

Pulp revenues for the three months ended September 30, 2012 increased to 205.1 million from 190.4 million in the comparative quarter of 2011, primarily due to record pulp sales volumes and a stronger U.S. dollar relative to the Euro, partially offset by lower average pulp realizations. The U.S. dollar was approximately 13% stronger versus the Euro in the current quarter compared to the same quarter of last year.

Energy and chemical revenues increased by approximately 10% to 18.2 million in the third quarter from 16.6 million in the same quarter last year, primarily as a result of strong production at all of our mills. Energy and chemical revenues in the quarter included 15.2 million from the sale of electricity and 2.9 million of revenue from the sale of a biochemical called tall oil. Tall oil had previously been classified as an offset to operating costs and has been included with revenues as we currently expect proceeds from the sale of tall oil to remain stable in future periods.

List prices for NBSK pulp in Europe were approximately 620 ($777) per ADMT in the current quarter, compared to 694 ($980) per ADMT in the same quarter last year. In the third quarter of 2012, average pulp sales realizations decreased by 14% to 501 ($627) per ADMT from 584 ($824) per ADMT in the same quarter last year, primarily due to lower pulp prices, partially offset by a stronger U.S. dollar relative to the Euro.

Pulp production increased to 373,369 ADMTs in the current quarter from 362,330 ADMTs in the same quarter of 2011, due to increased production at our Rosenthal and Stendal mills. We took seven days (approximately 10,200 ADMTs) of scheduled maintenance downtime at our Celgar mill in the third quarter of 2012.

Pulp sales volumes increased by approximately 26% and 16% to a record 404,301 ADMTs in the current quarter from 321,338 ADMTs and 349,177 ADMTs in the comparative and prior quarters, respectively, primarily as a result of increased sales to China. During the current quarter, our Celgar and Stendal mills ramped up sales volumes to realize upon increased demand from China in the latter part of the quarter and re-balanced their inventory levels.

Costs and expenses in the third quarter of 2012 increased by 26% to 216.1 million from 171.8 million in the comparative period of 2011, primarily due to a 26% increase in sales volumes.

In the third quarter of 2012, operating depreciation and amortization increased to 15.0 million from 13.8 million in the same quarter last year. Selling, general and administrative expenses were 10.0 million in the third quarter of 2012, compared to 8.8 million in the third quarter of 2011, primarily as a result of higher stock compensation and selling costs.

Transportation costs increased to 21.1 million in the third quarter of 2012 from 15.3 million in the third quarter of 2011, primarily due to higher sales volumes, including significantly higher sales to China.

On average, our per unit fiber costs in the current quarter decreased by approximately 9% from the same period in 2011, due to lower fiber costs in Germany caused by reduced demand for fiber by other residual fiber users. Fiber costs at our Celgar mill were slightly higher, primarily due to increased demand for fiber. As we move into the fourth quarter, we currently expect fiber prices for our German mills to increase slightly as a result of seasonal demand and to decline slightly at our Celgar mill due to increased regional sawmill activity.

For the third quarter of 2012, operating income decreased to 7.2 million from 35.3 million in the comparative quarter of 2011, primarily due to lower average pulp realizations, partially offset by a stronger U.S. dollar relative to the Euro and lower fiber costs.

Interest expense in the third quarter of 2012 and 2011 was unchanged at 14.1 million.

We recorded a derivative loss of 0.9 million, which includes an approximately 0.3 million gain related to a fixed price pulp swap contract entered into in the second quarter of 2012 and an unrealized loss of 1.2 million on the mark to market adjustment of our Stendal mill s interest rate derivative, compared to an unrealized derivative loss of 10.5 million in the same quarter of last year. We did not incur any foreign exchange gain or loss on our foreign currency denominated debt in the third quarter of 2012, compared to a loss of 0.2 million in the same period of 2011.

During the current quarter, we recorded an income tax expense of 1.9 million, compared to an expense of 3.1 million in the same quarter of 2011, due to decreased taxable income.

In the third quarter of 2012, the noncontrolling shareholder s interest in the Stendal mill s income was 0.6 million, compared to a loss of 0.8 million in the same quarter last year.

We reported a net loss attributable to common shareholders of 9.7 million, or 0.17 per basic and diluted share, for the third quarter of 2012, which included a total non-cash unrealized loss of 1.3 million on the fixed price pulp swaps and Stendal interest rate derivative and a non-cash charge for stock compensation of 0.9 million. In the third quarter of 2011, net income attributable to common shareholders was 8.4 million, or 0.15 per basic and diluted share, which included a non-cash unrealized loss of 10.7 million, or 0.19 per basic share, on the Stendal interest rate derivative and foreign exchange losses on certain of our foreign currency denominated debt and a non-cash charge for stock compensation of 0.3 million.

Operating EBITDA in the third quarter of 2012 was 22.3 million, compared to 49.2 million in the third quarter of 2011. 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 (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 September 30, 2012	Three Months Ended September 30, 2011
	(in thousands)	
Net income (loss) attributable to common shareholders	(9,712)	8,440
Net income (loss) attributable to noncontrolling interest	566	(838)
Income tax provision	1,910	3,124
Interest expense	14,084	14,117
Loss (gain) on derivative instruments	883	10,484
Foreign exchange loss on debt		181
Other expense (income)	(517)	(201)
Operating income	7,214	35,307
Add: Depreciation and amortization	15,054	13,893
Operating EBITDA	22,268	49,200

Nine Months Ended September 30, 2012 Compared to Nine Months Ended September 30, 2011

Total revenues for the nine months ended September 30, 2012 decreased to 645.7 million ($827.9 million) from 667.9 million ($939.5 million) in the same period of 2011, primarily due to lower average pulp prices, partially offset by higher pulp and energy sales volumes and a stronger U.S. dollar relative to the Euro.

Pulp revenues for the nine months ended September 30, 2012 decreased to 590.6 million from 618.2 million in the comparative period of 2011, primarily due to lower pulp prices, partially offset by higher sales volumes and a stronger U.S. dollar compared to the Euro. The U.S. dollar was approximately 10% stronger versus the Euro in the nine months ended September 30, 2012 compared to the same period of 2011.

Energy and chemical revenues increased by approximately 11% to 55.1 million in the nine months ended September 30, 2012 from 49.7 million in the same period last year, primarily as a result of strong production at all of our mills. Energy and chemical revenues in the period include 46.2 million in revenues from the sale of electricity at our mills and 8.9 million from the sale of tall oil at our Stendal mill.

List prices for NBSK pulp in Europe were approximately 637 ($817) per ADMT in the nine months ended September 30, 2012, compared to 701 ($986) per ADMT in the same period of 2011. In the nine months ended September 30, 2012, average pulp sales realizations decreased by 14% to 512 ($656) per ADMT from 592 ($833) per ADMT in the same period last year, primarily due to lower pulp prices, partially offset by a stronger U.S. dollar relative to the Euro.

Pulp production increased to 1,118,758 ADMTs in the nine months ended September 30, 2012 from 1,088,801 ADMTs in the same period of 2011, due to increased pulp production at our Celgar and Stendal mills.

Pulp sales volumes increased by approximately 11% to 1,138,304 ADMTs in the nine months ended September 30, 2012 from 1,027,918 ADMTs in the comparative period of 2011, primarily as a result of a significant increase in sales to China. During the third quarter of 2012, our Celgar and Stendal mills ramped up sales volumes to take advantage of increased demand from China in the latter part of the third quarter and re-balanced their inventory levels.

Costs and expenses in the nine months ended September 30, 2012 increased by approximately 8% to 603.9 million from 559.7 million in the same period of 2011, primarily due to an 11% increase in sales volumes, partially offset by lower fiber costs.

In the nine months ended September 30, 2012, operating depreciation and amortization increased to 43.8 million from 41.8 million in the same period last year. Selling, general and administrative expenses were 28.7 million in the nine months ended September 30, 2012, compared to 27.4 million in the same period of 2011.

Transportation costs increased to 56.5 million in the nine months ended September 30, 2012 from 47.5 million in the same period of 2011, primarily due to increased shipments to China and higher container costs.

On average, our per unit fiber costs in the nine months ended September 30, 2012 decreased by approximately 6% from the same period in 2011, primarily due to lower fiber costs in Germany caused by decreased demand from other residual fiber users. Fiber costs at our Celgar mill were higher, primarily due to increased demand for fiber. As we move into the fourth quarter, we currently expect fiber prices for our German mills to increase slightly as a result of seasonal demand and to decline slightly at our Celgar mill due to increased regional sawmill activity.

For the nine months ended September 30, 2012, operating income decreased to 41.8 million from 108.2 million in the same period of 2011, primarily due to lower pulp prices, partially offset by a stronger U.S. dollar relative to the Euro and lower fiber costs.

Interest expense in the nine months ended September 30, 2012 decreased to 42.1 million from 44.9 million in the comparative period of 2011, primarily due to reduced debt levels associated with the Stendal mill and the conversion of our remaining convertible notes in 2011.

We recorded a derivative gain of 1.3 million which included an approximately 1.9 million gain related to a fixed price pulp swap contract entered into in the second quarter of 2012, partially offset by an unrealized loss of 0.6 million on the mark to market adjustment of our Stendal mill s interest rate derivative during the nine months ended September 30, 2012, compared to an unrealized derivative loss of 0.6 million in the same period of 2011. We did not incur a foreign exchange gain or loss on our foreign currency denominated debt in the nine months ended September 30, 2012, compared to a gain of 1.3 million in the same period of 2011.

Our current tax expense increased to 7.2 million, compared to 3.9 million in the same period of 2011, primarily relating to changes in uncertain positions as a result of certain ongoing tax audits during the current period. Accordingly, we also reversed certain valuation allowances during the nine months ended September 30, 2012, resulting in a deferred tax recovery of 2.3 million, compared to a deferred tax provision of 3.7 million for the comparative period of 2011.

In the nine months ended September 30, 2012, the noncontrolling shareholder s interest in the Stendal mill s income was 2.9 million, compared to 5.2 million in the same period last year.

We reported net loss attributable to common shareholders of 7.0 million, or 0.13 per basic and diluted share, for the nine months ended September 30, 2012, which included a total non-cash unrealized gain of 0.8 million on the fixed price pulp swaps and Stendal interest rate derivative, more than offset by a non-cash charge for stock compensation of 1.8 million. In the nine months ended September 30, 2011, net income attributable to common shareholders was 51.9 million, or 1.07 per basic and 0.92 per diluted share, which included a non-cash unrealized loss of 0.6 million on the Stendal interest rate derivative, a 1.3 million non-cash foreign exchange gain on certain of our foreign currency denominated debt and a non-cash charge for stock compensation of 2.8 million.

Operating EBITDA in the nine months ended September 30, 2012 was 85.7 million, compared to 150.1 million in the same period of 2011. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our results for the three months ended September 30, 2012 for additional information relating to such limitations of Operating EBITDA.

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

	Nine Months Ended September 30,	
	2012	2011
	(in thousands)	
Net income (loss) attributable to common shareholders	(7,024)	51,876
Net income attributable to noncontrolling interest	2,865	5,175
Income tax provision	4,907	7,561
Interest expense	42,080	44,906
Loss (gain) on derivative instruments	(1,336)	580
Foreign exchange gain on debt		(1,272)
Other expense (income)	261	(664)
Operating income	41,753	108,162
Add: Depreciation and amortization	43,992	41,960
Operating EBITDA	85,745	150,122

Liquidity and Capital Resources

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

	As at September 30, 2012	As at December 31, 2011
	(in thousands)	
Financial Position		
Cash and cash equivalents	126,169	105,072
Marketable securities	190	12,372[(1)]
Working capital	220,480	247,159
Property, plant and equipment	815,661	820,974
Total assets	1,220,739	1,217,250
Long-term liabilities	775,041	807,641
Total equity	288,784	283,542

(1) Principally comprised of German federal government bonds with a maturity of less than one year.

As at September 30, 2012, our cash and cash equivalents and short-term German federal government bonds increased to 126.2 million from 117.3 million and working capital had decreased to 220.5 million from 247.2 million compared to the end of 2011.

Sources and Uses of Funds

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

In October 2012, we extended our 25.0 million Rosenthal revolving working capital facility to October 31, 2016.

Debt Covenants

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

Our Stendal mill has established the Stendal Loan Facility and a project loan facility for Project Blue Mill (collectively the Facilities) which require Stendal to maintain a similar leverage ratio of total debt thereunder to EBITDA (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 volatility in foreign exchange rates and pulp prices we can give no assurance that the Stendal mill will be in compliance with the Stendal Ratio as of December 31, 2012. We have entered into discussions with the Stendal mill s lenders and currently expect to receive, if required, a satisfactory amendment or waiver. Additionally, we have the right to cure any breach of the Stendal Ratio by providing additional equity to Stendal. 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 equity to Stendal, the Stendal mill would be in default under the Facilities and the Stendal mill s lenders would be entitled to pursue their remedies thereunder. This would have a material adverse effect on the Stendal mill, our business and our consolidated results of operations.

As at September 30, 2012, we were in compliance with all of the covenants of our indebtedness.

Cash Flow Analysis

Cash Flows from Operating Activities. We operate in a cyclical industry and our operating cash flows vary accordingly. Our principal operating cash expenditures are for labor, fiber 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 62.5 million in the nine months ended September 30, 2012 from 107.7 million in the comparative period of 2011, primarily due to our weaker operating results. An increase in accounts payable and accrued expenses provided cash of 13.1 million, compared to 24.9 million in the same period of 2011. A decrease in inventories provided cash of 9.3 million in the nine months ended September 30, 2012, compared to an increase in inventories using cash of 27.9 million in the same period of 2011. A decrease in receivables provided cash of 0.9 million in the nine months ended September 30, 2012, compared to 3.2 million in the same period of 2011.

Cash Flows from Investing Activities. Investing activities in the nine months ended September 30, 2012 used cash of 14.8 million, compared to using cash of 25.4 million in the same period of 2011. Capital expenditures in the nine months ended September 30, 2012 used cash of 27.5 million, compared to 26.1 million in the same period of 2011. Capital expenditures in the nine months ended September 30, 2012 primarily related to the recovery boiler upgrade project at our Rosenthal mill and Project Blue Mill at our Stendal mill. Proceeds on maturity of marketable securities provided cash of 12.2 million, compared to purchases of marketable securities using cash of 4.0 million in the same period of 2011.

Cash Flows from Financing Activities. In the nine months ended September 30, 2012, financing activities used cash of 27.3 million, primarily for scheduled Stendal loan facility principal repayments. In the comparative period of 2011, financing activities used cash of 53.5 million, primarily as a result of cash of 15.2 million used to redeem our 9.25% Senior Notes due 2013, 23.2 million used to repay the principal amount under the Stendal loan facility and 14.7 million used to repay borrowings under the revolving facility at our Celgar mill.

Capital Commitments and Future Liquidity

As at September 30, 2012, we had approximately 17.1 million of capital commitments related to our 40.0 million Project Blue Mill at the Stendal mill and deposited 7.1 million in a separate investment account to manage Project Blue Mill s costs and funding. Project Blue Mill has also received an investment decree, determining that it qualifies for up to 12.0 million in governmental grants, comprised of 9.2 million of investment incentives and 2.8 million of tax grants. The actual receipt of such grants is subject to the Stendal mill satisfying all governmental rules including verification. The investment decree is a condition of our accessing the Project Blue Mill loan facility. The Stendal mill, based on expenditures to date, has currently applied for 1.2 million in grants and is awaiting approval and receipt.

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 nine months ended September 30, 2012.

The collective agreement with our hourly workers at our Celgar mill expired on April 30, 2012. Initial collective agreement discussions with the union are currently underway. The Union has received a strike vote from the hourly workers and can effect a strike at the mill upon 72 hours notice. We continue to work toward a satisfactory new agreement with the Celgar work forces. However, currently we can provide no assurance that we can achieve such an agreement without a work stoppage or other disruption. A significant work stoppage or disruption at the Celgar mill could have a material adverse effect on our consolidated results of operations.

Foreign Currency

Our reporting currency is the Euro as the majority of our business transactions are denominated in Euros. However, we hold certain assets and liabilities in U.S. dollars and Canadian dollars. Accordingly, our consolidated financial results are subject to foreign currency exchange rate fluctuations.

We translate foreign denominated assets and liabilities into Euros at the rate of exchange on the balance sheet date. 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 nine months ended September 30, 2012, accumulated other comprehensive income increased by 7.8 million to 29.1 million, primarily due to the foreign currency translation adjustment.

Based upon the exchange rate at September 30, 2012, the U.S. dollar has strengthened by approximately 5% in value against the Euro since September 30, 2011. See Quantitative and Qualitative Disclosures about Market Risk .

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

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

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.

Restricted Group Results Three Months Ended September 30, 2012 Compared to Three Months Ended September 30, 2011

Total revenues for the Restricted Group increased to 119.7 million ($149.9 million) in the third quarter of 2012, compared to 117.8 million ($166.3 million) in the third quarter of 2011, primarily due to higher pulp and energy sales volumes and a stronger U.S. dollar relative to the Euro, partially offset by lower average pulp realizations.

Pulp revenues for the Restricted Group for the three months ended September 30, 2012 increased marginally to 112.8 million from 111.6 million in the comparative period of 2011, primarily due to higher pulp sales volumes and a stronger U.S. dollar relative to the Euro, largely offset by lower average pulp realizations. The U.S. dollar was approximately 13% stronger versus the Euro in the third quarter of 2012 compared to the third quarter of 2011. Energy revenues increased by approximately 15% in the current quarter to 7.0 million from 6.1 million in the same period last year, due to increased energy sales at our Celgar and Rosenthal mills.

List prices for NBSK pulp in Europe were approximately 620 ($777) per ADMT in the current quarter, compared to 694 ($980) per ADMT in the same quarter last year. In the third quarter of 2012, average pulp sales realizations for the Restricted Group decreased by 14% to 502 ($629) per ADMT from 587 ($829) per ADMT in the same period last year due to lower pulp prices, partially offset by a stronger U.S. dollar relative to the Euro.

Pulp production for the Restricted Group marginally decreased to 204,124 ADMTs in the third quarter of 2012 from 206,907 ADMTs in the same period of 2011, primarily due to lower production at our Celgar mill.

Pulp sales volumes of the Restricted Group increased by approximately 18% to 224,696 ADMTs in the third quarter of 2012 from 190,013 ADMTs in the comparative period of 2011, primarily due to increased sales to China. During the current quarter, our Celgar mill ramped up sales volumes to realize upon increased demand from China and re-balanced its inventory levels.

Costs and expenses for the Restricted Group in the third quarter of 2012 increased by approximately 25% to 124.5 million from 99.4 million in the comparative period of 2011, primarily due to an approximately 18% increase in sales volumes.

In the third quarter of 2012, operating depreciation and amortization for the Restricted Group was 8.3 million, compared to 7.4 million in the same quarter last year. Selling, general and administrative expenses for the Restricted Group were 6.4 million, compared to 6.1 million in the same period of 2011.

Transportation costs for the Restricted Group increased to 14.6 million in the third quarter of 2012 from 11.6 million in the same quarter last year due to increased volume of sales, including increased sales to China.

Overall, per unit fiber costs of the Restricted Group in the third quarter of 2012 decreased by approximately 4% compared to the same period in 2011, due to lower fiber costs at our Rosenthal mill resulting from reduced demand for fiber from other residual fiber users.

In the third quarter of 2012, the Restricted Group reported an operating loss of 4.8 million compared to operating income of 18.3 million in the third quarter of 2011, primarily due to lower average pulp sales realizations, partially offset by a stronger U.S. dollar relative to the Euro.

Interest expense for the Restricted Group increased to 6.0 million in the third quarter of 2012 from 5.5 million in the same quarter last year, primarily due to the foreign exchange impact on the interest expense of our U.S. dollar denominated Senior Notes.

In the third quarter of 2012, there was no foreign exchange effect on the Restricted Group s foreign currency denominated debt, compared to a loss of 0.2 million in the third quarter of 2011. The Restricted Group also recorded a gain on derivative instruments of approximately 0.3 million related to a fixed price pulp swap contract entered into in the second quarter of 2012.

During the third quarter of 2012, the Restricted Group recorded 1.2 million of income tax expense, compared to income tax expense of 2.6 million in the same period last year.

The Restricted Group reported a net loss for the third quarter of 2012 of 10.0 million, compared to net income of 11.4 million in the same period last year.

In the third quarter of 2012, the Restricted Group reported Operating EBITDA of 3.6 million, compared to Operating EBITDA of 25.8 million in the comparative quarter of 2011. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our consolidated results for the three months ended September 30, 2012 for additional information relating to such limitations of Operating EBITDA.

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

	Three Months Ended September 30,	
	2012	2011
	(in thousands)	
Restricted Group[1]		
Net income (loss)	(9,957)	11,371
Income tax provision	1,192	2,566
Interest expense	6,010	5,496
Gain on derivative instruments	(353)	
Foreign exchange loss on debt		181
Other expense (income)	(1,665)	(1,265)
Operating income (loss)	(4,773)	18,349
Add: Depreciation and amortization	8,385	7,425
Operating EBITDA	3,612	25,774

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

Restricted Group Results Nine Months Ended September 30, 2012 Compared to Nine Months Ended September 30, 2011

Total revenues for the Restricted Group decreased to 347.8 million ($445.9 million) in the nine months ended September 30, 2012, compared to 369.8 million ($520.2 million) in the same period of 2011 due to lower average pulp realizations, partially offset by higher energy revenues and a stronger U.S. dollar relative to the Euro.

Pulp revenues for the Restricted Group for the nine months ended September 30, 2012 decreased to 326.4 million from 352.1 million in the comparative period of 2011, primarily due to lower pulp prices, partially offset by higher sales volumes and a stronger U.S. dollar relative to the Euro. The U.S. dollar was approximately 10% stronger versus the Euro in the nine months ended September 30, 2012, compared to the same period of 2011. Energy revenues increased by approximately 21% in the nine months ended September 30, 2012 to 21.4 million from 17.7 million in the same period last year, primarily due to increased energy sales at our Celgar mill.

List prices for NBSK pulp in Europe were approximately 637 ($817) per ADMT in the nine months ended September 30, 2012, compared to 701 ($986) per ADMT in the same period last year. In the nine months ended September 30, 2012, average pulp sales realizations for the Restricted Group decreased by approximately 14% to 514 ($659) per ADMT from 596 ($838) per ADMT in the same period last year.

Pulp production for the Restricted Group increased marginally to 616,837 ADMTs in the nine months ended September 30, 2012 from 611,139 ADMTs in the same period of 2011.

Pulp sales volumes of the Restricted Group increased to 634,687 ADMTs in the nine months ended September 30, 2012 from 590,448 ADMTs in the comparative period of 2011, primarily due to increased sales to China.

Costs and expenses for the Restricted Group in the nine months ended September 30, 2012 increased to 345.0 million from 312.1 million in the comparative period of 2011, primarily due to higher sales volumes.

In the nine months ended September 30, 2012, operating depreciation and amortization for the Restricted Group was 23.8 million, compared to 22.4 million in the same period last year. Selling, general and administrative expenses for the Restricted Group increased slightly to 18.3 million from 17.6 million in the comparative period of 2011.

Transportation costs for the Restricted Group increased to 40.3 million in the nine months ended September 30, 2012 from 35.1 million in the same period last year due to increased shipments to China.

Overall, per unit fiber costs of the Restricted Group in the nine months ended September 30, 2012 were flat, compared to the same period in 2011.

In the nine months ended September 30, 2012, the Restricted Group reported operating income of 2.8 million compared to operating income of 57.7 million in the same period of 2011, primarily due to lower average pulp realizations.

Interest expense for the Restricted Group decreased to 17.8 million in the nine months ended September 30, 2012 from 19.2 million in the same period last year, primarily due to the conversion of our convertible notes in 2011.

In the nine months ended September 30, 2012, there was no foreign exchange effect on the Restricted Group s foreign currency denominated debt, compared to a gain of 1.3 million in the nine months ended September 30, 2011.

The Restricted Group recorded a gain on derivative instruments of approximately 1.9 million related to a fixed price pulp swap contract entered into in the second quarter of 2012, compared to nil in the same period last year.

Other income for the Restricted Group decreased to 3.4 million in the nine months ended September 30, 2012 from 3.8 million in the same period of 2011, primarily as a result of the net costs of our take-over bid for Fibrek Inc.

During the nine months ended September 30, 2012, the Restricted Group recorded 3.3 million of income tax expense, compared to income tax expense of 5.9 million in the same period last year.

The Restricted Group reported a net loss of 12.8 million for the nine months ended September 30, 2012, compared to net income of 37.6 million in the same period last year.

In the nine months ended September 30, 2012, the Restricted Group reported Operating EBITDA of 26.8 million compared to Operating EBITDA of 80.2 million in the comparative period of 2011. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our consolidated results for the three months ended September 30, 2012 for additional information relating to such limitations of Operating EBITDA.

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

	Nine Months Ended September 30,	
	2012	2011
	(in thousands)	
Restricted Group[1]		
Net income (loss)	(12,842)	37,631
Income tax provision	3,305	5,941
Interest expense	17,754	19,202
Gain on derivative instruments	(1,972)	
Foreign exchange gain on debt		(1,272)
Other expense (income)	(3,405)	(3,849)
Operating income	2,840	57,653
Add: Depreciation and amortization	23,958	22,562
Operating EBITDA	26,798	80,215

(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 September 30, 2012	As at December 31, 2011
	(in thousands)	
Restricted Group Financial Position[1]		
Cash and cash equivalents	55,023	44,829
Marketable securities	190	12,372[2]
Working capital	135,654	149,973
Property, plant and equipment	356,302	353,925
Total assets	671,448	658,844
Long-term liabilities	265,923	262,770
Total equity	340,974	344,415

(1) See Note 11 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results.
(2) Principally comprised of German federal government bonds with a maturity of less than one year.

At September 30, 2012, cash and cash equivalents and holdings of short-term German federal government bonds for the Restricted Group decreased to 55.0 million from 57.0 million at the end of 2011.

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.

In October 2012, we extended our 25.0 million Rosenthal revolving working capital facility to October 31, 2016.

Critical Accounting Policies

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

Our significant accounting policies are disclosed in Note 1 to our annual report on Form 10-K for the fiscal year ended December 31, 2011. While all of the significant accounting policies are important to the consolidated financial statements, some of these policies may be viewed as having a high degree of judgment. On an ongoing basis, using currently available information, management reviews its estimates, including those related to the accounting for pensions and post-retirement benefits, provisions for bad debt and doubtful accounts, derivative instruments, impairment of long-lived assets, deferred taxes, inventory provisions and environmental conservation and legal liabilities. Actual results could differ from these estimates.

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

For information about both our significant and critical accounting policies, see our annual report on Form 10-K for the fiscal year ended December 31, 2011.

New Accounting Standards

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

Cautionary Statement Regarding Forward-Looking Information

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

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 conditio 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 weak 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;

increases in our capital expenditures or maintenance costs could have a material adverse effect on our cash flow and our ability to satisfy our debt obligations;

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

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

Project Blue Mill might not generate the results we expect;

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

we are subject to risks related to our employees;

we rely on German federal and state government grants and guarantees;

risks relating to our participation in the European Union Emissions Trading Scheme and the application of Germany s *Renewable Energy Resources Act*;

we are dependent on key personnel;

we may experience material disruptions to our production;

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; and

we rely on third parties for transportation services.

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, 2011. We advise you that these cautionary remarks expressly qualify in their entirety all forward-looking statements attributable to us or persons acting on our behalf. Unless required by law, we do not assume any obligation to update forward-looking statements based on unanticipated events or changed expectations. However, you should carefully review the reports and other documents we file from time to time with the SEC.

Cyclical Nature of Business

Revenues

The pulp business is highly cyclical in nature and markets for our principal products are characterized by periods of supply and demand imbalance, which in turn affects product prices. Pulp markets are highly competitive and are sensitive to cyclical changes in the global economy, industry capacity and foreign exchange rates, all of which can have a significant influence on selling prices and our operating results. The length and magnitude of industry cycles have varied over time but generally reflect changes in macro-economic conditions and levels of industry capacity.

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

Demand for pulp has historically been determined by the level of economic growth and has been closely tied to overall business activity. From 2006 to mid-2008, pulp prices in Europe steadily improved. However, in the latter half of 2008, a global economic crisis resulted in a sharp decline of European pulp prices from a high of $900 per ADMT to $635 per ADMT at the end of 2008. 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. Despite continued economic uncertainty in Europe, European pulp prices stabilized, averaging approximately $837 per ADMT in the first half of 2012, before declining to $760 per ADMT at the end of the third quarter of 2012.

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, the pulp price may fall below our cash production costs, requiring us to either incur short-term losses on product sales or cease production at one or more of our mills. Therefore, our profitability depends on managing our cost structure, particularly raw materials which represent a significant component of our operating costs and can fluctuate based upon factors beyond our control. If the prices of our products decline, or if prices for our raw materials increase, or both, our results of operations could be materially adversely affected.

Costs

Our production costs are influenced by the availability and cost of raw materials, energy and labor, and our plant efficiencies and productivity. Our main raw material is fiber in the form of wood chips and pulp logs. Fiber costs are primarily affected by the supply of, and demand for, lumber which is highly cyclical in nature and can vary significantly by location. 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. Conversely, an increase in the U.S. dollar versus the Euro and the Canadian dollar positively impacts our revenues by increasing our operating margins and cash flow.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

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

During the nine months ended September 30, 2012 and 2011, we recorded an unrealized loss of 0.6 million on our outstanding interest rate derivative.

We entered into a fixed price pulp swap contract in the second quarter of 2012. The contract fixes the price of 5,000 tonnes of pulp each month between May and December 2012 at $915. We recorded a gain of approximately 1.9 million related to this swap contract in the nine months ended September 30, 2012.

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

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the *Securities Exchange Act of 1934*, as amended (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, 2011. 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, 2011.

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
10.1	Extension, Amendment and Confirmation Letter dated October 4, 2012 among Zellstoff- und Papierfabrik Rosenthal GmbH, D&Z Holding GmbH, D&Z Beteiligungs GmbH, ZPR Logistik GmbH and Mercer International Inc.
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1*	Section 906 Certification of Chief Executive Officer
32.2*	Section 906 Certification of Chief Financial Officer

*

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

SIGNATURES

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

MERCER INTERNATIONAL INC.

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

Date: November 2, 2012