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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from _________ to _________

Commission File No.: 000-51826

MERCER INTERNATIONAL INC.

(Exact name of Registrant as specified in its charter)

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

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

(Address of office)

(604) 684-1099

(Registrant s telephone number, including area code)

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

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

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

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

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

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

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED JUNE 30, 2013

(Unaudited)

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands of Euros)

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

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

Commitments and contingencies (Note 10)
Subsequent events (Note 11)
The accompanying notes are an integral part of these interim consolidated financial statements.

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands of Euros, except per share data)

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

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

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands of Euros)

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

INTERIM CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

(Unaudited)

(In thousands of Euros)

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

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

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands of Euros)

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

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

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Unaudited)

(In thousands of Euros)

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

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

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 1. The Company and Summary of Significant Accounting Policies

Basis of Presentation

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

The interim consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC). The year-end Consolidated Balance Sheet data was derived from audited financial statements. The footnote disclosure included herein has been prepared in accordance with accounting principles generally accepted for interim financial statements in the United States (GAAP). The interim consolidated financial statements should be read together with the audited consolidated financial statements and accompanying notes included in the Company s latest annual report on Form 10-K for the fiscal year ended December 31, 2012. In the opinion of the Company, the unaudited interim consolidated financial statements contained herein contain all adjustments necessary to fairly present the results of the interim periods included. The results for the periods included herein may not be indicative of the results for the entire year.

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

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

Use of Estimates

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

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 2. Inventories

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

Note 3. Debt

Debt consists of the following:

	June 30, 2013	December 31, 2012
Note payable to bank, included in a total loan credit facility of 827,950 to finance the construction related to the Stendal mill (a)	432,907	452,907
Senior notes, interest at 9.50% accrued and payable semi-annually, unsecured (b)	218,571	215,670
Credit agreement with a lender with respect to a revolving credit facility of C$40 million (c)	7,311	4,574
Term bank facility for a project at the Stendal mill of 17,000 (d)	17,000	
Loans payable to the noncontrolling shareholder of the Stendal mill (e)	37,556	36,620
Investment loan agreement with a lender with respect to a project at the Rosenthal mill of 4,351 (f)	1,088	1,632
Credit agreement with a bank with respect to a revolving credit facility of 25,000 (g)	10,000	
Credit agreement with a bank with respect to a revolving credit facility of 5,000 (h)		
	724,433	711,403
Less: current portion	(44,346)	(45,662)
Debt, less current portion	680,087	665,741

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

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

	724,433

Certain of the Company s debt instruments were issued under an indenture which, among other things, restricts its ability and the ability of its restricted subsidiaries to make certain payments. These limitations are subject to specific exceptions. As at June 30, 2013, the Company was in compliance with the terms of the indenture.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 3. Debt (continued)

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

On March 13, 2009, the Company finalized an agreement with its lenders to amend its Stendal Loan Facility. The amendment deferred approximately 164,000 of scheduled principal payments until the maturity date, September 30, 2017. The amendment also provided for a 100% cash sweep, referred to as the Cash Sweep , of any cash, in excess of a 15,000 working capital reserve, the Guarantee Amount, as discussed in Note 10(a) Commitments and Contingencies, and other amounts as contemplated in the amendment, held by Stendal which will be used first to fund the DSRA to a level sufficient to service the amounts due and payable under the Stendal Loan Facility during the then following 12 months, which means the DSRA is Fully Funded , and second to prepay the deferred principal amounts. As at June 30, 2013, the DSRA balance was 32,992 and was not Fully Funded.

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

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

In June 2012, the Company s Board of Directors authorized the purchase of up to 50,000 in aggregate principal amount of the Company s Senior Notes from time to time, over a period ending June 2013. During the six month period ended June 30, 2013, the Company did not purchase any of its outstanding Senior Notes. During the twelve month period ended December 31, 2012, the Company purchased $2.0 million of its outstanding Senior Notes.

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

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

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MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 3. Debt (continued)

(c) Credit agreement with respect to a revolving credit facility of up to C$40.0 million for the Celgar mill. The credit facility matures May 2016. Borrowings under the credit facility are collateralized by the mill s inventory and receivables and are restricted by a borrowing base calculated on the mill s inventory and receivables. Canadian dollar denominated amounts bear interest at bankers acceptance plus 1.75% or Canadian prime plus 0.25%. U.S. dollar denominated amounts bear interest at LIBOR plus 1.75% or U.S. base plus 0.25%. As at June 30, 2013, this facility was accruing interest at a rate of approximately 3.25%, C$10.0 million of this facility was drawn, C$1.7 million was supporting letters of credit and approximately C$17.6 million was available.

(d) A 17,000 amortizing term facility to partially finance a project, referred to as Project Blue Mill , which is expected to increase the Stendal mill s annual pulp production capacity by 30,000 air-dried metric tonnes and includes the installation of an additional 40 megawatt steam turbine. The facility, 80% of which is guaranteed by the State of Saxony-Anhalt, bears interest at a rate of Euribor plus 3.5% per annum. The interest period for the facility, at the choice of the Company, will be of one, three or six months duration and interest is paid on the last day of the interest period selected. The facility, together with accrued interest, is scheduled to mature in September 2017. The facility will be repaid semi-annually, commencing September 30, 2013, is collateralized by the gross assets of the Stendal mill, and will be non-recourse to the Company. As at June 30, 2013, the facility was fully drawn and accruing interest at a rate of approximately 3.61%.

As part of the term facility, the Company was required to open an investment account with the lender for the purpose of managing project costs and is required to deposit all funding associated with Project Blue Mill in this account. As at June 30, 2013, the balance in the investment account was 6,053.

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

As at June 30, 2013, accrued interest on these loans was 10,796. As at December 31, 2012, accrued interest on these loans was 9,860.

(f) A four-year amortizing investment loan agreement with a lender relating to the wash press project at the Rosenthal mill with a total facility of 4,351 bearing interest at the rate of Euribor plus 2.75% that matures February 2014. Borrowings under this agreement are secured by the wash press equipment. As at June 30, 2013, the balance outstanding was 1,088 and was accruing interest at a rate of 3.13%.

(g) A 25,000 working capital facility at the Rosenthal mill that matures in October 2016. Borrowings under the facility are collateralized by the mill s inventory and receivables and bear interest at Euribor plus 3.50%. As at June 30, 2013, this facility was accruing interest at a rate of approximately 3.61%, 10,000 of this facility was drawn, approximately 1,300 of this facility was supporting bank guarantees leaving approximately 13,700 available.

(h)

A   5,000 facility at the Rosenthal mill that matures in December 2015. Borrowings under this facility bear interest at the rate of the three-month Euribor plus 3.50% and are secured by certain land at the Rosenthal mill. As at June 30, 2013, approximately   1,000 of this facility was supporting bank guarantees leaving approximately   4,000 available.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 4. Pension and Other Post-Retirement Benefit Obligations

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

Pension benefits are based on employees earnings and years of service. The Celgar Plans are funded by contributions from the Company based on actuarial estimates and statutory requirements. Pension contributions during the three and six month periods ended June 30, 2013 totaled 405 and 902, respectively (2012 511 and 1,012).

Effective December 31, 2008, the defined benefit plan was closed to new members. In addition, the defined benefit service accrual ceased on December 31, 2008, and members began to receive pension benefits, at a fixed contractual rate, under a new defined contribution plan effective January 1, 2009. During the three and six month periods ended June 30, 2013, the Company made contributions of 117 and 291, respectively (2012 159 and 320) to this plan.

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

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

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

The Company participates in a multiemployer plan for hourly-paid employees at the Celgar mill. The contributions to this plan are determined based on an amount per hour worked pursuant to a collective bargaining agreement. The Company has no current or future contribution obligations in excess of the contractual contributions. During the three and six month periods ended June 30, 2013, the Company made contributions of 380 and 761, respectively (2012 463 and 940) to this plan.

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 5. Share Capital

Common shares

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

As at June 30, 2013, the Company had 55,853,704 common shares issued and outstanding. As at December 31, 2012, the Company had 55,815,704 common shares issued and outstanding. During the six months ended June 30, 2013, the Company issued 38,000 restricted shares to directors of the Company.

Share Repurchase Program

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

Preferred shares

The Company has authorized 50,000,000 preferred shares with $1 par value issuable in series, of which 2,000,000 shares have been designated as Series A. The preferred shares may be issued in one or more series and with such designations and preferences for each series as shall be stated in the resolutions providing for the designation and issue of each such series adopted by the Board of Directors of the Company. The Board of Directors is authorized by the Company s articles of incorporation to determine the voting, dividend, redemption and liquidation preferences pertaining to each such series. As at June 30, 2013, no preferred shares had been issued by the Company.

Note 6. Stock-Based Compensation

The Company has a stock incentive plan (the 2010 Plan) which provides for options, restricted stock rights, restricted shares, performance shares, performance share units (PSUs) and stock appreciation rights to be awarded to employees, consultants and non-employee directors. As at June 30, 2013, after factoring in all allocated shares, there remain approximately 1.1 million common shares available for grant pursuant to the 2010 Plan.

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

The following table summarizes restricted share activity during the period:

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

Vested	(76,500)
Outstanding at June 30, 2013	158,000

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

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

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

(1) The basic weighted average number of shares excludes 158,000 restricted shares which have been issued, but have not vested as at June 30, 2013 (2012 196,500 restricted shares).

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	**2012**	**2013**	**2012**
PSUs	786,129		786,129	
Restricted shares	158,000	196,500	158,000	196,500
Stock options	175,000	75,000	175,000	75,000

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(In thousands of Euros, except per share data)

Note 8. Derivative Transactions

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

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

Interest Rate Derivative

During 2004, the Company entered into certain variable-to-fixed interest rate swaps in connection with the Stendal mill with respect to an aggregate maximum amount of approximately 612,600 of the principal amount of the indebtedness under the Stendal Loan Facility. Under the remaining interest rate swap, the Company pays a fixed rate and receives a floating rate with the interest payments being calculated on a notional amount. As at June 30, 2013, the contract has an aggregate notional amount of 332,684 at a fixed interest rate of 5.28% and it matures in October 2017 (which for the most part matches the maturity of the Stendal Loan Facility).

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

Pulp Price Derivatives

In May 2012, the Company entered into a fixed price pulp swap contract with a bank. Under the terms of the contract, 5,000 metric tonnes (MT) of pulp per month was fixed at a price of $915 per MT. The contract expired in December 2012. In November 2012, the Company entered into two additional contracts. Under the terms of the contracts, 3,000 MT of pulp per month is fixed at prices which range from $880 to $890 per MT. These contracts expire in December 2013.

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

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

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Note 9. Financial Instruments

The fair value of financial instruments is summarized as follows:

	June 30, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	134,433	134,433	104,239	104,239
Marketable securities	167	167	184	184
Receivables	97,028	97,028	110,087	110,087
Pulp price derivative contracts asset	245	245	745	745
Accounts payable and other	96,002	96,002	89,950	89,950
Debt	724,433	715,322	711,403	700,001
Interest rate derivative contract liability	39,798	39,798	50,678	50,678

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

Fair Value Measurement and Disclosure

The fair value methodologies and, as a result, the fair value of the Company s investments, debt and derivative instruments are determined based on the fair value hierarchy provided in the Fair Value Measurements and Disclosures topic of the FASB Accounting Standards Codification, and are as follows:

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

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

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

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

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

The Company s debt is recognized at amortized cost. The fair value of debt classified as Level 2 reflects recent market transactions and discounted cash flow estimates. Discounted cash flow models use observable market inputs taking into consideration variables such as interest rate changes, comparative securities, subordination discount and credit rating changes. The fair value of debt classified as Level 3 is valued using a discounted cash flow model which requires significant management estimates. These estimates are developed using available market, historical, and forecast data, including taking into account variables such as recent financing activities, the capital structure, and the lack of marketability of such debt.

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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Note 9. Financial Instruments (continued)

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

	Fair Value Measurements at June 30, 2013			
Description	Level 1	Level 2	Level 3	Total
Assets				
Marketable securities	167			167
Pulp price derivative contracts		245		245
	167	245		412
Liabilities				
Interest rate derivative contract		39,798		39,798
Debt		702,177	13,145	715,322
		741,975	13,145	755,120

	Fair Value Measurements at December 31, 2012			
Description	Level 1	Level 2	Level 3	Total
Assets				
Marketable securities	184			184
Pulp price derivative contracts		745		745
	184	745		929
Liabilities				
Interest rate derivative contract		50,678		50,678
Debt		687,184	12,817	700,001
		737,862	12,817	750,679

Note 10. Commitments and Contingencies

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

The 10,000 was initially recognized as an increase in cash and a corresponding increase in accounts payable and other. As civil works remediation steps are agreed to with the noncontrolling shareholder an agreed to portion of the payable is reversed with the offset recorded in operating costs to offset the remediation expenditures. As at June 30, 2013, the Company had Guarantee Amount proceeds of 1,768 remaining in accounts payable and other.

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Note 10. Commitments and Contingencies (continued)

(b) The Company is involved in a property transfer tax dispute with respect to the Celgar mill and certain other legal actions and claims arising in the ordinary course of business. Celgar had previously paid the property transfer tax assessment. During the second quarter of 2013, the Company lost its Supreme Court of British Columbia appeal of the property transfer tax assessment and as a result the Company filed an application to seek leave to appeal to the British Columbia Court of Appeal. The outcome of the appeal process is uncertain. In addition, while the outcome of any legal actions and claims cannot be predicted with certainty, it is the opinion of management that the outcome of any such claim which is pending or threatened, either individually or on a combined basis, will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company.

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

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

Note 11. Subsequent Events

(a) In July 2013, the Company announced a workforce reduction at the Celgar mill. The planned reduction will affect both hourly and salaried employees and will reduce the workforce by approximately 85 employees over the next five years, with the majority of employees to be affected over the next 12 months. In connection with implementing this work force reduction, the Company currently estimates that it will incur pre-tax charges in the range of approximately $6.0 million to $8.0 million for severance and other personnel expenses, such as termination benefits, which are expected to occur primarily over the 12-month period commencing with the third quarter of 2013. More than 85% of such charges are expected to be recognized by the end of 2013.

(b) In July 2013, the Company issued $50.0 million in aggregate principal amount of its Senior Notes. See Note 3(b) Debt for a description of the Senior Notes. The additional notes were priced at 104.50% plus accrued interest from June 1, 2013. The net proceeds from the offering were $50.5 million, after deducting the underwriter s discounts, offering expenses and accrued interest. The Company used the net proceeds from the offering to repay the revolving credit facilities of the Rosenthal and Celgar mills and for general corporate purposes.

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(In thousands of Euros, except per share data)

Note 12. Restricted Group Supplemental Disclosure

The terms of the indenture governing our Senior Notes require that we provide the results of operations and financial condition of Mercer International Inc. and our restricted subsidiaries under the indenture, collectively referred to as the Restricted Group . As at and during the three and six months ended June 30, 2013 and 2012, the Restricted Group was comprised of Mercer International Inc., certain holding subsidiaries and our Rosenthal and Celgar mills. The Restricted Group excludes the Stendal mill.

Combined Condensed Balance Sheets

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

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

MERCER INTERNATIONAL INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of Euros, except per share data)

Note 12. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Balance Sheets

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

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

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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(In thousands of Euros, except per share data)

Note 12. Restricted Group Supplemental Disclosure (continued)

Combined Condensed Statements of Operations

	Three Months Ended June 30, 2013			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues				
Pulp	105,541	88,118		193,659
Energy and chemicals	6,040	10,447		16,487
	111,581	98,565		210,146
Operating costs	103,558	83,322		186,880
Operating depreciation and amortization	8,258	6,486		14,744
Selling, general and administrative expenses	5,644	3,719		9,363