MERCER INTERNATIONAL INC.
Form 10-Q
August 03, 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 June 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 August 2, 2012.

# PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

**MERCER INTERNATIONAL INC.**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE SIX MONTHS ENDED JUNE 30, 2012**

**(Unaudited)**

**MERCER INTERNATIONAL INC.**

**INTERIM CONSOLIDATED BALANCE SHEETS**

**(Unaudited)**

**(In thousands of Euros)**

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| **ASSETS** | | |
| Current assets | | |
| Cash and cash equivalents | 130,887 | 105,072 |
| Marketable securities | 10,201 | 12,216 |
| Receivables | 103,923 | 120,487 |
| Inventories (Note 2) | 118,220 | 120,539 |
| Prepaid expenses and other | 8,592 | 8,162 |
| Deferred income tax | 8,271 | 6,750 |
| Total current assets | 380,094 | 373,226 |
| Long-term assets | | |
| Property, plant and equipment | 816,892 | 820,974 |
| Deferred note issuance and other | 12,561 | 10,763 |
| Deferred income tax | 16,148 | 12,287 |
| | 845,601 | 844,024 |
| Total assets | 1,225,695 | 1,217,250 |
| **LIABILITIES** | | |
| Current liabilities | | |
| Accounts payable and other | 103,879 | 99,640 |
| Pension and other post-retirement benefit obligations (Note 4) | 773 | 756 |
| Debt (Note 3) | 36,088 | 25,671 |
| Total current liabilities | 140,740 | 126,067 |
| Long-term liabilities | | |
| Debt (Note 3) | 694,150 | 708,415 |
| Unrealized interest rate derivative losses (Note 8) | 51,791 | 52,391 |
| Pension and other post-retirement benefit obligations (Note 4) | 31,798 | 31,197 |
| Capital leases and other | 13,453 | 13,053 |
| Deferred income tax | 3,895 | 2,585 |
| | 795,087 | 807,641 |
| Total liabilities | 935,827 | 933,708 |
| **EQUITY** | | |
| Shareholders equity | | |
| Share capital (Note 5) | 248,371 | 247,642 |
| Paid-in capital | (4,726) | (4,857) |
| Retained earnings | 40,673 | 37,985 |
| Accumulated other comprehensive income | 21,825 | 21,346 |

| | | |
|---|---|---|
| Total shareholders equity | 306,143 | 302,116 |
| Noncontrolling deficit | (16,275) | (18,574) |
| Total equity | 289,868 | 283,542 |
| Total liabilities and equity | 1,225,695 | 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 June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Revenues | | | | |
| Pulp | 186,036 | 217,274 | 385,475 | 427,732 |
| Energy and chemicals | 18,026 | 17,221 | 36,945 | 33,093 |
| | 204,062 | 234,495 | 422,420 | 460,825 |
| Costs and expenses | | | | |
| Operating costs | 162,617 | 175,815 | 340,387 | 341,365 |
| Operating depreciation and amortization | 14,525 | 13,869 | 28,812 | 27,945 |
| | 26,920 | 44,811 | 53,221 | 91,515 |
| Selling, general and administrative expenses | 8,624 | 8,600 | 18,682 | 18,660 |
| Operating income | 18,296 | 36,211 | 34,539 | 72,855 |
| Other income (expense) | | | | |
| Interest expense | (13,863) | (14,883) | (27,996) | (30,789) |
| Gain (loss) on derivative instruments (Note 8) | 1,343 | (2,339) | 2,219 | 9,904 |
| Foreign exchange gain on debt | | 342 | | 1,453 |
| Other income (expense) | (368) | 136 | (778) | 463 |
| Total other income (expense) | (12,888) | (16,744) | (26,555) | (18,969) |
| Income before income taxes | 5,408 | 19,467 | 7,984 | 53,886 |
| Income tax benefit (provision) current | (6,281) | (1,478) | (6,337) | (2,297) |
| deferred | 4,016 | (2,140) | 3,340 | (2,140) |
| Net income | 3,143 | 15,849 | 4,987 | 49,449 |
| Less: net income attributable to noncontrolling interest | (1,628) | (1,466) | (2,299) | (6,013) |
| Net income attributable to common shareholders | 1,515 | 14,383 | 2,688 | 43,436 |
| Net income per share attributable to common shareholders (Note 7) | | | | |
| Basic | 0.03 | 0.32 | 0.05 | 0.97 |
| Diluted | 0.03 | 0.26 | 0.05 | 0.77 |

*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 June 30, 2012 | Three Months Ended June 30, 2011 | Six Months Ended June 30, 2012 | Six Months Ended June 30, 2011 |
|---|---|---|---|---|
| Net income attributable to common shareholders | 1,515 | 14,383 | 2,688 | 43,436 |
| Retained earnings (deficit), beginning of period | 39,158 | 18,097 | 37,985 | (10,956) |
| Retained earnings, end of period | 40,673 | 32,480 | 40,673 | 32,480 |

**INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Unaudited)**

**(In thousands of Euros)**

| | Three Months Ended June 30, 2012 | Three Months Ended June 30, 2011 | Six Months Ended June 30, 2012 | Six Months Ended June 30, 2011 |
|---|---|---|---|---|
| Net income | 3,143 | 15,849 | 4,987 | 49,449 |
| Other comprehensive income (loss), net of taxes | | | | |
| Foreign currency translation adjustment during the three and six month periods, net of tax benefit of 1,118 and 1,208, respectively (2011 nil and nil, respectively) | (1,334) | (864) | 813 | 2,600 |
| Pension income (expense) | (485) | 127 | (336) | 403 |
| Unrealized gains (losses) on securities arising during the period | (66) | (6) | 2 | |
| Other comprehensive income (loss), net of taxes | (1,885) | (743) | 479 | 3,003 |
| Total comprehensive income | 1,258 | 15,106 | 5,466 | 52,452 |
| Comprehensive income attributable to noncontrolling interest | (1,628) | (1,466) | (2,299) | (6,013) |
| Comprehensive income (loss) attributable to common shareholders | (370) | 13,640 | 3,167 | 46,439 |

*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, 2012 | Three Months Ended June 30, 2011 | Six Months Ended June 30, 2012 | Six Months Ended June 30, 2011 |
|---|---|---|---|---|
| Cash flows from (used in) operating activities | | | | |
| Net income attributable to common shareholders | 1,515 | 14,383 | 2,688 | 43,436 |
| Adjustments to reconcile net income attributable to common shareholders to cash flows from operating activities | | | | |
| Loss (gain) on derivative instruments | (1,343) | 2,339 | (2,219) | (9,904) |
| Foreign exchange gain on debt | | (342) | | (1,453) |
| Depreciation and amortization | 14,588 | 13,929 | 28,938 | 28,067 |
| Accretion expense | | 289 | | 759 |
| Noncontrolling interest | 1,628 | 1,466 | 2,299 | 6,013 |
| Deferred income taxes | (4,016) | 2,140 | (3,340) | 2,140 |
| Stock compensation expense | (6) | 471 | 862 | 2,539 |
| Pension and other post-retirement expense, net of funding | (41) | 7 | (55) | (7) |
| Other | 73 | 919 | 866 | 1,603 |
| Changes in current assets and liabilities | | | | |
| Receivables | 12,338 | 5,523 | 15,023 | 12,700 |
| Inventories | (8,296) | (8,399) | 3,442 | (4,086) |
| Accounts payable and accrued expenses | 805 | (833) | 3,454 | 24,555 |
| Other | (86) | 485 | 1,338 | 844 |
| Net cash from (used in) operating activities | 17,159 | 32,377 | 53,296 | 107,206 |
| Cash flows from (used in) investing activities | | | | |
| Purchase of property, plant and equipment | (9,838) | (7,756) | (18,303) | (15,825) |
| Proceeds on sale of property, plant and equipment | 113 | 27 | 339 | 380 |
| Proceeds on sale of marketable securities | 2,008 | | 2,008 | |
| Note receivable | | 375 | | 771 |
| Net cash from (used in) investing activities | (7,717) | (7,354) | (15,956) | (14,674) |
| Cash flows from (used in) financing activities | | | | |
| Repayment of notes payable and debt | (1,584) | | (11,710) | (30,351) |
| Repayment of capital lease obligations | (448) | (638) | (1,059) | (1,493) |
| Repayment of credit facilities, net | (3,759) | | | (14,652) |
| Payment of note issuance costs | | | (1,621) | |
| Proceeds from government grants | 1,692 | 4,837 | 2,322 | 8,949 |
| Net cash from (used in) financing activities | (4,099) | 4,199 | (12,068) | (37,547) |
| Effect of exchange rate changes on cash and cash equivalents | 1,348 | (668) | 543 | (2,212) |
| Net increase in cash and cash equivalents | 6,691 | 28,554 | 25,815 | 52,773 |
| Cash and cash equivalents, beginning of period | 124,196 | 123,241 | 105,072 | 99,022 |
| Cash and cash equivalents, end of period | 130,887 | 151,795 | 130,887 | 151,795 |

*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, | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Supplemental disclosure of cash flow information | | | | |
| Cash paid during the period for | | | | |
| Interest | 21,439 | 23,406 | 26,266 | 29,920 |
| Income taxes | 411 | 35 | 3,019 | 336 |
| Supplemental schedule of non-cash investing and financing activities | | | | |
| Acquisition of production and other equipment under capital lease obligations | 774 | (37) | 774 | 273 |
| Increase (decrease) in accounts payable related to investing and financing activities | 422 | 3,635 | (1,323) | 3,486 |
| Increase (decrease) in accounts receivable and other current assets related to investing activities | (1,695) | (2,686) | (2,333) | (2,890) |

*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 six month periods ended June 30, 2012 was 3,179 and 5,987, respectively (2011 3,280 and 5,475).

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**

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Raw materials | 37,985 | 48,063 |
| Finished goods | 46,201 | 41,392 |
| Spare parts, work in process and other | 34,034 | 31,084 |
| | 118,220 | 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:

| | June 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) | 467,907 | 477,490 |
| Senior notes due December 2017, interest at 9.50% accrued and payable semi-annually, unsecured (b) | 224,472 | 220,753 |
| Credit agreement with a lender with respect to a revolving credit facility of C$40 million (c) | | |
| Term bank facility for project at the Stendal mill of 17,000 (d) | | |
| Loans payable to the noncontrolling shareholder of the Stendal mill (e) | 35,683 | 33,124 |
| Investment loan agreement with a lender with respect to the wash press project at the Rosenthal mill of 4,351 (f) | 2,176 | 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) | | |
| | 730,238 | 734,086 |
| Less: current portion | (36,088) | (25,671) |
| Debt, less current portion | 694,150 | 708,415 |

The Company made principal repayments under these facilities of 11,710 during the six month period ended June 30, 2012 (2011 30,351). As of June 30, 2012, the principal maturities of debt are as follows:

| Matures | Amount |
|---|---|
| 2012 | 15,544 |
| 2013[(1)] | 41,088 |
| 2014 | 40,544 |
| 2015 | 44,000 |
| 2016 | 44,000 |
| Thereafter | 545,062 |
| | 730,238 |

(1) Includes 20,544 of principal debt repayments recorded as current debt as at June 30, 2012.

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 June 30, 2012, the Company was in compliance with the terms of the indenture.

(a) Note payable to bank, included in a total loan facility of 827,950 to finance the construction related to the Stendal mill ( Stendal Loan Facility ), interest at rates varying from Euribor plus 0.90% to Euribor plus 1.80% (rates on amounts of borrowing at June 30, 2012 range from 2.14% to 2.89%), 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 407,907 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.

**MERCER INTERNATIONAL INC.**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

**Note 3. Debt (continued)**

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, 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, 2012, the DSRA balance was 31,800 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. During the six month period ended June 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. 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.

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 June 30, 2012, approximately C$36.3 million was available.

(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 June 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 June 30, 2012 the balance in the investment account was 9,470; this cash was from shareholder loans entered into in January 2012 and operating cash flows.

**MERCER INTERNATIONAL INC.**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

**Note 3. Debt (continued)**

(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 June 30, 2012, accrued interest on these loans was 8,923. As at December 31, 2011, accrued interest on these loans 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 August 2013. Borrowings under this agreement are secured by the new wash press equipment. As at June 30, 2012, the balance outstanding was 2,176 and was accruing interest at a rate of 4.17%.

(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 June 30, 2012, approximately 2,100 of this facility was supporting bank guarantees leaving approximately 22,900 available.