

MERCER INTERNATIONAL INC.

Form 10-Q

May 09, 2011

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

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

**For the quarterly period ended March 31, 2011
OR**

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

For the transition period from _____ to _____

Commission File No.: 000-51826

MERCER INTERNATIONAL INC.

(Exact name of Registrant as specified in its charter)

Washington

*(State or other jurisdiction
of incorporation or organization)*

Suite 2840, 650 West Georgia Street, Vancouver, British Columbia, Canada, V6B 4N8

(Address of office)

(604) 684-1099

(Registrant's telephone number, including area code)

47-0956945

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

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

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

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

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

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

The Registrant had 45,790,343 shares of common stock outstanding as at May 6, 2011.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**MERCER INTERNATIONAL INC.
INTERIM CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2011
(Unaudited)**

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

	March 31, 2011	December 31, 2010
ASSETS		
Current assets		
Cash and cash equivalents	123,241	99,022
Receivables	112,991	121,709
Inventories (Note 4)	96,408	102,219
Prepaid expenses and other	10,787	11,360
Deferred income tax	22,414	22,570
Total current assets	365,841	356,880
Long-term assets		
Property, plant and equipment	830,095	846,767
Deferred note issuance and other	10,461	11,082
Note receivable	890	1,346
	841,446	859,195
Total assets	1,207,287	1,216,075
LIABILITIES		
Current liabilities		
Accounts payable and accrued expenses	108,765	84,873
Pension and other post-retirement benefit obligations (Note 7)	703	728
Debt (Note 5)	45,393	39,596
Total current liabilities	154,861	125,197
Long-term liabilities		
Debt (Note 5)	713,422	782,328
Unrealized interest rate derivative losses (Notes 6 and 9)	38,730	50,973
Pension and other post-retirement benefit obligations (Note 7)	23,412	24,236
Capital leases and other	11,607	12,010
Deferred income tax	7,947	7,768
	795,118	877,315
Total liabilities	949,979	1,002,512

EQUITY

Shareholders' equity		
Share capital (Note 8)	227,588	219,211
Paid-in capital	(5,877)	(3,899)
Retained earnings (deficit)	18,097	(10,956)
Accumulated other comprehensive income	35,458	31,712
Total shareholders' equity	275,266	236,068
Noncontrolling interest (deficit)	(17,958)	(22,505)
Total equity	257,308	213,563
Total liabilities and equity	1,207,287	1,216,075

Commitments and contingencies (Note 10)

Subsequent Events (Note 11)

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

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MERCER INTERNATIONAL INC.
INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands of Euros, except per share data)

	Three Months Ended	
	March 31,	
	2011	2010
Revenues		
Pulp	210,458	171,121
Energy	13,677	9,131
	224,135	180,252
Costs and expenses		
Operating costs	163,355	140,409
Operating depreciation and amortization	14,076	13,724
	46,704	26,119
Selling, general and administrative expenses	10,230	8,095
Purchase (sale) of emission allowances	(170)	
Operating income (loss)	36,644	18,024
Other income (expense)		
Interest expense	(15,906)	(16,423)
Investment income (loss)	327	94
Foreign exchange gain (loss) on debt	1,111	(5,231)
Gain (loss) on extinguishment of debt (Note 5)		(929)
Gain (loss) on derivative instruments (Note 6)	12,243	(6,546)
Total other income (expense)	(2,225)	(29,035)
Income (loss) before income taxes	34,419	(11,011)
Income tax benefit (provision) current	(819)	(204)
deferred		
Net income (loss)	33,600	(11,215)
Less: net loss (income) attributable to noncontrolling interest	(4,547)	3,669
Net income (loss) attributable to common shareholders	29,053	(7,546)
Net income (loss) per share attributable to common shareholders (Note 3)		
Basic	0.66	(0.21)
Diluted	0.52	(0.21)

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

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MERCER INTERNATIONAL INC.
INTERIM CONSOLIDATED STATEMENTS OF RETAINED EARNINGS (DEFICIT)
(Unaudited)
(In thousands of Euros)

	Three Months Ended	
	March 31,	
	2011	2010
Net income (loss) attributable to common shareholders	29,053	(7,546)
Retained earnings (deficit), beginning of period	(10,956)	(97,235)
Retained earnings (deficit), end of period	18,097	(104,781)

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

	Three Months Ended	
	March 31,	
	2011	2010
Net income (loss)	33,600	(11,215)
Other comprehensive income (loss), net of taxes		
Foreign currency translation adjustment	3,464	7,632
Pension income (expense)	276	(366)
Unrealized gains (losses) on securities arising during the period	6	6
Other comprehensive income (loss), net of taxes	3,746	7,272
Total comprehensive income (loss)	37,346	(3,943)
Comprehensive (income) loss attributable to noncontrolling interest	(4,547)	3,669
Comprehensive income (loss) attributable to common shareholders	32,799	(274)

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

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

	Three Months Ended	
	March 31,	
	2011	2010
Cash flows from (used in) operating activities		
Net income (loss) attributable to common shareholders	29,053	(7,546)
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities		
Loss (gain) on derivative instruments	(12,243)	6,546
Foreign exchange (gain) loss on debt	(1,111)	5,231
Loss (gain) on extinguishment of debt		929
Depreciation and amortization	14,138	13,821
Accretion expense (income)	470	431
Noncontrolling interest	4,547	(3,669)
Stock compensation expense	2,068	506
Pension and other post-retirement expense, net of funding	(14)	194
Other	684	1,003
Changes in current assets and liabilities		
Receivables	7,177	(17,144)
Inventories	4,313	(5,259)
Accounts payable and accrued expenses	25,388	7,955
Other	359	(1,281)
Net cash from (used in) operating activities	74,829	1,717
Cash flows from (used in) investing activities		
Purchase of property, plant and equipment	(8,069)	(5,850)
Proceeds on sale of property, plant and equipment	353	387
Note receivable	396	(84)
Net cash from (used in) investing activities	(7,320)	(5,547)
Cash flows from (used in) financing activities		
Repayment of notes payable and debt	(30,351)	(8,250)
Repayment of capital lease obligations	(855)	(1,004)
Proceeds from (repayment of) credit facilities, net	(14,652)	
Proceeds from government grants	4,112	9,415
Net cash from (used in) financing activities	(41,746)	161
Effect of exchange rate changes on cash and cash equivalents	(1,544)	1,070

Net increase (decrease) in cash and cash equivalents	24,219	(2,599)
Cash and cash equivalents, beginning of period	99,022	51,291
Cash and cash equivalents, end of period	123,241	48,692
Supplemental disclosure of cash flow information		
Cash paid during the period for		
Interest	6,514	14,429
Income taxes	301	102
Supplemental schedule of non-cash investing and financing activities		
Acquisition of production and other equipment under capital lease obligations	310	212
Decrease (increase) in accounts payable relating to investing activities	55	(983)

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

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

(In thousands of Euros, except per share data)

Note 1. The Company and Summary of Significant Accounting Policies

Basis of Presentation

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

The interim consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC). The year-end consolidated balance sheet data was derived from audited financial statements. The footnote disclosure included herein has been prepared in accordance with accounting principles generally accepted for interim financial statements in the United States (GAAP). The interim consolidated financial statements should be read together with the audited consolidated financial statements and accompanying notes included in the Company's latest annual report on Form 10-K for the fiscal year ended December 31, 2010. In the opinion of the Company, the unaudited interim consolidated financial statements contained herein contain all adjustments necessary to fairly present the results of the interim periods included. The results for the periods included herein may not be indicative of the results for the entire year.

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

Certain prior year amounts in the interim consolidated financial statements have been reclassified to conform to the current year presentation.

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

Use of Estimates

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

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

(In thousands of Euros, except per share data)

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

Recently Implemented Accounting Standards

There were no recently implemented accounting standards that had an impact on the Company's financial statements.

Note 2. Stock-Based Compensation

In June 2010, the Company adopted a new stock incentive plan (the 2010 Plan) which provides for options, restricted stock rights, restricted stock, performance shares, performance share units and stock appreciation rights to be awarded to employees, consultants and non-employee directors. As at March 31, 2011, after factoring in all allocated stock, there remain approximately 1.2 million common shares available for grant pursuant to the 2010 Plan.

Performance Stock

Grants of performance stock comprise rights to receive stock at a future date that are contingent on the Company and the grantee achieving certain performance objectives.

In February 2011, the Company awarded a total of 812,573 potential stock based performance awards to employees of the Company, the majority of which vest using a partial vesting schedule between 2014 and 2016; 50% are scheduled to vest on January 1, 2014, 25% are scheduled to vest on January 1, 2015, and the remaining 25% are scheduled to vest on January 1, 2016. There were nil performance stock which had vested, forfeited, or been cancelled during the three months ended March 31, 2011. Expense recognized for the three month period ended March 31, 2011 was 521. Performance stock are expensed each reporting period based on their fair value, which is then amortized to reflect the time elapsed in the vesting period. The fair value of the performance stock is determined based upon the targeted number of shares awarded and the quoted price of the Company's stock 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 will be determined by the Board of Directors.

Between February and March 2011, the Company granted and issued a total of 474,728 shares of common stock for stock based performance awards, which were originally awarded in 2008 and had vested on December 31, 2010. Pursuant to the accounting guidance in FASB's Accounting Standards Codification No. 718, Compensation - Stock Compensation, the Company adjusted the number of performance units awarded to employees to the number granted by the Board of Directors, and accordingly adjusted compensation cost based on the fair value of Mercer's common stock at the grant date. As a result, the Company recognized approximately 1,420 associated with the final determination of these performance shares. The fair value of these performance shares was determined based upon the number of shares granted and the quoted price of the Company's stock at the grant date.

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

(In thousands of Euros, except per share data)

Note 2. Stock-Based Compensation (continued)

Restricted Stock

The fair value of restricted stock is determined based upon the number of shares granted and the quoted price of the Company's stock on the date of grant. Restricted stock generally vests over a one-year period, except as noted below. Expense is recognized on a straight-line basis over the vesting period.

During the three months ended March 31, 2011, 200,000 restricted stock awards were granted to the Chief Executive Officer of the Company, which vest in equal amounts over a five-year period commencing in 2012.

There were no restricted stock awards cancelled or forfeited during the three-month period ended March 31, 2011. As at March 31, 2011, the total number of unvested restricted stock was 256,000 (2010 21,000).

Expense recognized for the three-month period ended March 31, 2011 was 127 (2010 3). As at March 31, 2011, the total remaining unrecognized compensation cost related to restricted stock amounted to approximately 1,781 (2010 4), which will be amortized over the remaining vesting periods.

Stock Options

During the three-month periods ended March 31, 2011 and 2010, no options were granted, exercised or cancelled and 15,000 options expired (2010 738,334). The aggregate intrinsic value of options outstanding and currently exercisable as at March 31, 2011 was \$7.03 per option.

Stock compensation expense recognized for stock options for the three-month period ended March 31, 2011 was nil (2010 nil). All stock options have fully vested.

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

(In thousands of Euros, except per share data)

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

	Three Months Ended March 31,	
	2011	2010
Net income (loss) attributable to common shareholders basic	29,053	(7,546)
Interest on convertible notes, net of tax	403	
Net income (loss) attributable to common shareholders diluted	29,456	(7,546)
Net income (loss) per share attributable to common shareholders		
Basic	0.66	(0.21)
Diluted	0.52	(0.21)
Weighted average number of common shares outstanding:		
Basic ⁽¹⁾	44,076,427	36,320,190
Effect of dilutive instruments:		
Performance rights	330,977	
Restricted stock	76,979	
Stock options and awards	72,197	
Convertible notes	12,440,562	
Diluted	56,997,142	36,320,190

(1) The basic weighted average number of shares excludes performance and restricted stock which have been issued, but have not vested as at March 31, 2011 and 2010.

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.

Performance stock, restricted stock, stock options and awards, and shares associated with the convertible notes excluded from the calculation of diluted income (loss) per share attributable to common shareholders because they were anti-dilutive represented 375,586, 21,000, 190,000 and 20,227,893 shares, respectively, for the three-month period ended March 31, 2010.

Note 4. Inventories

	March 31, 2011	December 31, 2010
Raw materials	36,392	47,179
Finished goods	31,052	27,127
Work in process and other	28,964	27,913
	96,408	102,219

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MERCER INTERNATIONAL INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(In thousands of Euros, except per share data)

Note 5. Debt

Debt consists of the following:

	March 31, 2011	December 31, 2010
Note payable to bank, included in a total loan credit facility of 827,950 to finance the construction related to the Stendal mill (a)	486,074	500,657
Senior notes due February 2013, interest at 9.25% accrued and payable semi-annually, unsecured (b)		15,341
Senior notes due December 2017, interest at 9.50% accrued and payable semi-annually, unsecured (c)	211,536	224,031
Subordinated convertible notes due January 2012, interest at 8.5% accrued and payable semi-annually (d)	26,138	31,707
Credit agreement with a lender with respect to a revolving credit facility of C\$40 million (e)		15,016
Loan payable to the noncontrolling shareholder of the Stendal mill (f)	31,804	31,365
Credit agreement with a bank with respect to a revolving credit facility of 25,000 (g)		
Investment loan agreement with a lender with respect to the wash press project at the Rosenthal mill of 4,351 (h)	3,263	3,807
Credit agreement with a bank with respect to a revolving credit facility of 3,500 (i)		
	758,815	821,924
Less: current portion	(45,393)	(39,596)
Debt, less current portion	713,422	782,328

The Company made principal repayments under these facilities of 30,351 during the three months ended March 31, 2011 (2010 8,250). As of March 31, 2011, the principal maturities of debt are as follows:

Matures	Amount
2011	9,126
2012 ⁽¹⁾	51,810
2013	41,088
2014	40,544
2015	44,000
Thereafter	572,247
	758,815

(1) Including subordinated convertible notes due 2012 of 26,138 recorded as current debt as at March 31, 2011.

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 March 31, 2011, the Company was in compliance with the terms of the indenture.

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

(In thousands of Euros, except per share data)

Note 5. Debt (continued)

- (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 1.58% (rates on amounts of borrowing at March 31, 2011 range from 2.43% to 3.22%), 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 433,573 of outstanding principal, subject to a debt service reserve account required to pay amounts due in the following twelve months under the terms of the Stendal Loan Facility; payment of dividends is only permitted if certain cash flow requirements are met.

On March 13, 2009, the Company finalized an agreement with its lenders to amend its Stendal Loan Facility. The amendment deferred approximately 164,000 of scheduled principal payments until the maturity date, September 30, 2017. 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 described in Note 10, held by Stendal which will be used first to fund the debt service reserve account to a level sufficient to service the amounts due and payable under the Stendal Loan Facility during the then following 12 months, or Fully Funded , and second to prepay the deferred principal amounts. As at March 31, 2011, the debt service reserve balance was approximately 7,000. Effective April 1, 2011, the debt service reserve balance was increased to approximately 28,300.

- (b) In February 2005, the Company issued \$310 million of senior notes due February 2013 (2013 Notes), which bore interest at 9.25% accrued and payable semi-annually, and were unsecured.

On November 17, 2010, the Company used the proceeds from a private offering of \$300 million senior notes due 2017, described in Note 5(c) below and cash on hand to complete a tender offer to repurchase approximately \$289 million aggregate principal amount of its 2013 Notes. Pursuant to the FASB's Accounting Standards Codification No. 405, Liabilities - Extinguishment of Liabilities (ASC 405-20), the Company concluded that the tendering of the 2013 Notes met the definition of a debt extinguishment. In connection with this tender offer and pursuant to FASB's Accounting Standards Codification No. 470-50, Debt-Modifications and Extinguishments (ASC 470-50), the Company recorded approximately 7,500 to the loss on extinguishment of debt line in the Consolidated Statement of Operations which included the tender premium paid and the write-off of unamortized debt issue costs.

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**MERCER INTERNATIONAL INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(In thousands of Euros, except per share data)**

Note 5. Debt (continued)

On February 15, 2011, the Company redeemed for cash all of its outstanding 2013 Notes, for a price equal to 100% of the principal amount of \$20.5 million, plus accrued and unpaid interest to, but not including February 15, 2011. In total, the Company paid approximately \$21.5 million (15,900) in connection with the redemption of the 2013 Notes.

- (c) On November 17, 2010, the Company completed a private offering of \$300 million in aggregate principal amount of Senior Notes due 2017 (2017 Notes). The proceeds from this offering were used to finance the tender offer and consent solicitation for approximately \$289 million of the Company's 2013 Notes, (see Note 5(b)). The 2017 Notes were issued at a price of 100% of their principal amount. The 2017 Notes will mature on December 1, 2017 and bear interest at 9.5% which is accrued and payable semi-annually.

The 2017 Notes are general unsecured senior obligations of the Company. The 2017 Notes rank equal in right of payment with all existing and future indebtedness of the Company and senior in right of payment to any current or future subordinated indebtedness of the Company. The 2017 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 2017 Notes, upon not less than 30 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.

- (d) In December, 2009, the Company exchanged approximately \$43.3 million of Subordinated Convertible Notes due October 2010 (the 2010 Notes) through two private exchange agreements with the holders thereof for approximately \$43.8 million of Subordinated Convertible Notes due January 2012 (the 2012 Notes). On January 22, 2010, through an exchange offer with the remaining holders of the 2010 Notes, the Company exchanged a further \$21.7 million of 2010 Notes for approximately \$22.0 million of the Company's 2012 Notes. The Company recognized both exchange transactions of the Subordinated Convertible Notes as extinguishments of debt in accordance with ASC 470-50, because the fair value of the embedded conversion option changed by more than 10% in both transactions. During 2010, the Company recognized a loss of 929 as a result of the January 22, 2010 exchange. The loss was determined using the fair market value prevailing at the time of the transaction, and will be accreted to income through to January 2012 through interest expense yielding an effective interest rate of approximately 3% on the January 22, 2010 exchange.

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MERCER INTERNATIONAL INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(In thousands of Euros, except per share data)

Note 5. Debt (continued)

The 2012 Notes bear interest at 8.50%, accrued and payable semi-annually, are convertible at any time by the holder into common shares of the Company at \$3.30 per share and are unsecured. The Company may redeem for cash all or a portion of the notes on or after July 15, 2011 at 100% of the principal amount of the notes plus accrued interest up to the redemption date. During the three months ended March 31, 2011, approximately \$6.0 million of Subordinated Convertible Notes due January 2012 were converted into 1,828,178 shares, respectively. The Company recorded a debt conversion expense of approximately 0.1 million during the three months ended March 31, 2011, as a result of the conversions, which is included within interest expense in the Interim Consolidated Statements of Operations.

- (e) Credit agreement with respect to a revolving credit facility of C\$40.0 million for the Celgar mill. The credit agreement matures May 2013. Borrowings under the credit agreement are collateralized by the mill's inventory and receivables and are restricted by a borrowing base calculated on the mill's inventory and receivables. Canadian dollar denominated amounts bear interest at bankers acceptance plus 3.75% or Canadian prime plus 2.00%. U.S. dollar denominated amounts bear interest at LIBOR plus 3.75% or U.S. base plus 2.00%. During the three months ended March 31, 2011, the Company fully repaid this facility. As at March 31, 2011, approximately C\$2.1 million of this facility was supporting letters of credit, leaving approximately C\$35.0 million undrawn.
- (f) A loan 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. The balance includes principal and accrued interest. During the first quarter of 2010, the noncontrolling shareholder converted 6,275 of accrued interest into a capital contribution.
- (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 March 31, 2011, approximately 2,200 of this facility was supporting bank guarantees leaving approximately 22,800 undrawn.
- (h) On August 19, 2009 the Company finalized an investment loan agreement with a lender relating to the new wash press at the Rosenthal mill. The four-year amortizing investment loan was completed with a total facility of 4,351 bearing interest at the rate of Euribor plus 2.75%. Borrowings under this agreement are secured by the new wash press equipment. As at March 31, 2011, this facility was drawn by 3,263 and was accruing interest at a rate of 4.07%.
- (i) On February 8, 2010 the Rosenthal mill finalized a credit agreement with a lender for a 3,500 facility maturing in December 2012. Borrowings under this facility will bear interest at the rate of the 3-month Euribor plus 3.50% and are secured by certain land at the Rosenthal mill. As at March 31, 2011, this facility was undrawn.

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**MERCER INTERNATIONAL INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(In thousands of Euros, except per share data)**

Note 6. Derivative Transactions

The Company is exposed to certain market risks relating to its ongoing business. The Company seeks to manage these risks through internal risk management policies as well as, from time to time, the use of derivatives. Currently, the only risk managed using derivative instruments is interest rate risk.

During 2004, the Company entered into certain variable-to-fixed interest rate swaps in connection with the Stendal Loan Facility with respect to an aggregate maximum principal amount of approximately 612,600 of the total indebtedness under the Stendal Loan Facility. Under the interest rate swaps, the Company pays a fixed rate and receives a floating rate with the interest payments being calculated on a notional amount. Currently, the contracts have an aggregate notional amount of 447,763 at a fixed interest rate of 5.28% and they mature October 2017 (generally matching the maturity of the Stendal Loan Facility). The Company substantially converted the Stendal Loan Facility from a variable interest rate loan into a fixed interest rate loan, thereby reducing interest rate uncertainty.

The Company recognized an unrealized gain of 12,243 with respect to these interest rate swaps for the three months ended March 31, 2011 (2010 a loss of 6,546), in the Gain (loss) on derivative instruments line in the Interim Consolidated Statements of Operations and Interim Consolidated Statements of Cash Flows. Derivative instruments are required to be measured at their fair value. Accordingly, the fair value of the interest rate swap is presented in

Unrealized interest rate derivative losses within the long-term liabilities section in the Interim Consolidated Balance Sheets, which currently amounts to a cumulative unrealized loss of 38,730 (2010 50,973).

The interest rate derivative contracts are with the same banks that hold the Stendal Loan Facility and the Company does not anticipate non-performance by the banks.

Note 7. Pension and Other Post-Retirement Benefit Obligations

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

Pension benefits are based on employees' earnings and years of service. The Celgar Plans are funded by contributions from the Company based on actuarial estimates and statutory requirements. Pension contributions during the three-month period ended March 31, 2011 totaled 465 (2010 156).

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

Effective December 31, 2008, the defined benefit plan was closed to new members. In addition, the defined benefit service accrual ceased on December 31, 2008, and members began to receive pension benefits, at a fixed contractual rate, under a new defined contribution plan effective January 1, 2009.

	Three Months Ended March 31,			
	2011		2010	
	Pension	Post-	Pension	Post-
	Benefits	Retirement	Benefits	Retirement
		Benefits		Benefits
Service cost	22	120	19	93
Interest cost	385	208	397	183
Expected return on plan assets	(395)		(371)	
Recognized net loss (gain)	130	(18)	104	(74)
Net periodic benefit cost	142	310	149	202

Note 8. Share Capital*Common shares*

The Company has authorized 200,000,000 common shares (2010 200,000,000) with a par value of \$1 per share. During the three months ended March 31, 2011, 1,828,178 shares were issued as a result of certain holders of the 2012 Notes exercising their conversion option (see Note 5(d) Debt). In addition, 358,268 shares were issued to employees of the Company as part of the stock based performance awards and 200,000 shares of restricted stock were issued to the Chief Executive Officer of the Company.

As at March 31, 2011 and December 31, 2010, the Company had 45,386,104 and 42,999,658 common shares issued and outstanding, respectively.

Preferred shares

The Company has authorized 50,000,000 preferred shares (2010 50,000,000) with \$1 par value issuable in series, of which 2,000,000 shares have been designated as Series A. The preferred shares may be issued in one or more series and with such designations and preferences for each series as shall be stated in the resolutions providing for the designation and issue of each such series adopted by the Board of Directors of the Company. The Board of Directors is authorized by the Company's articles of incorporation to determine the voting, dividend, redemption and liquidation preferences pertaining to each such series. As at March 31, 2011, no preferred shares had been issued by the Company.

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MERCER INTERNATIONAL INC.
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Note 9. Financial Instruments

The fair value of financial instruments at March 31, 2011 and December 31, 2010 is summarized as follows:

	March 31, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	123,241	123,241	99,022	99,022
Investments	258	258	275	275
Receivables	112,991	112,991	121,709	121,709
Note receivable	2,428	2,428	2,978	2,978
Accounts payable and accrued expenses	108,765	108,765	84,873	84,873
Debt	758,815	839,528	821,924	847,875
Interest rate derivative contracts liability	38,730	38,730	50,973	50,973

The carrying value of cash and cash equivalents and accounts payable and accrued expenses approximates the fair value due to the immediate or short-term maturity of these financial instruments. The carrying value of receivables approximates the fair value due to their short-term nature and historical collectability. The fair value of notes receivable was estimated using discounted cash flows at prevailing market rates. The fair value of debt reflects recent market transactions and discounted cash flow estimates. The fair value of the interest rate derivatives is based on observable inputs including applicable yield curves. Investments are recorded at fair value based on recent transactions.

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 FASB's Accounting Standards Codification No. 820, Fair Value Measurements and Disclosures (ASC 820). The fair value hierarchy per ASC 820 is as follows:

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

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

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

The Company classified its investments within Level 1 of the valuation hierarchy where quoted prices are available in an active market. Level 1 investments include exchange-traded equities.

The Company's derivatives are classified within Level 2 of the valuation hierarchy, as they are traded on the over-the-counter market and are valued using internal models that use as their basis readily observable market inputs, such as forward interest rates.

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MERCER INTERNATIONAL INC.
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Note 9. Financial Instruments (continued)

The valuation techniques used by the Company are based upon observable inputs. Observable inputs reflect market data obtained from independent sources. In addition, the Company considered the risk of non-performance of the obligor, which in some cases reflects the Company's own credit risk, in determining the fair value of the derivative instruments. The counterparty to our interest rate swap derivative is a multi-national financial institution.

The following table presents a summary of the Company's outstanding financial instruments and their estimated fair values under the hierarchy defined in ASC 820:

Fair value measurements at March 31, 2011 using:

Description	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets				
Investments (a)	258			258
Liabilities				
Derivatives (b)				
Interest rate swaps		38,730		38,730

(a) Based on observable market data.

(b) Based on observable inputs for the liability (yield curves observable at specific intervals).

Note 10. Commitments and Contingencies

The Company is involved in certain legal actions and claims arising in the ordinary course of business. While the outcome of these legal actions and claims cannot be predicted with certainty, it is the opinion of management that the outcome of any such claim which is pending or threatened, either individually or on a combined basis, will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company.

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 designed 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. As at March 31, 2011, the Guarantee Amount was recognized as an increase in cash, and a corresponding increase in accounts payable until such funds are spent on remediation.

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**MERCER INTERNATIONAL INC.
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(In thousands of Euros, except per share data)

Note 11. Subsequent Events

In January 2011, the Company finalized a contribution agreement with Natural Resources Canada (NRCan) for approximately C\$9.7 million of Mercer s allocated Green Transformation Program funding towards improving the fiber line and oxygen delignification process at the Celgar mill, referred to as the Oxygen Delignification Project . On April 12, 2011, the Company received approximately C\$3.8 million from NRCan pursuant to the terms of the contribution agreement, which was accrued in the Interim Consolidated Balance Sheet at March 31, 2011.

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MERCER INTERNATIONAL INC.
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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 9.5% senior unsecured notes require that we provide the results of operations and financial condition of Mercer International Inc. and our restricted subsidiaries under the indenture, collectively referred to as the Restricted Group. As at and during the three months ended March 31, 2011 and 2010, the Restricted Group was comprised of Mercer International Inc., certain holding subsidiaries and our Rosenthal and Celgar mills. The Restricted Group excludes the Stendal mill.

Combined Condensed Balance Sheets

	March 31, 2011			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
ASSETS				
Current assets				
Cash and cash equivalents	57,202	66,039		123,241
Receivables	63,063	49,928		112,991
Inventories	59,663	36,745		96,408
Prepaid expenses and other	6,582	4,205		10,787
Deferred income tax	22,414			22,414
Total current assets	208,924	156,917		365,841
Long-term assets				
Property, plant and equipment	350,034	480,061		830,095
Deferred note issuance and other	6,437	4,024		10,461
Due from unrestricted group	82,303		(82,303)	
Note receivable	890			890
Total assets	648,588	641,002	(82,303)	1,207,287
LIABILITIES				
Current liabilities				
Accounts payable and accrued expenses	53,444	55,321		108,765
Pension and other post-retirement benefit obligations	703			703
Debt	27,226	18,167		45,393
Total current liabilities	81,373	73,488		154,861
Long-term liabilities				
Debt	213,711	499,711		713,422
Due to restricted group		82,303	(82,303)	
Unrealized interest rate derivative losses		38,730		38,730
Pension and other post-retirement benefit obligations	23,412			23,412

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Capital leases and other	6,990	4,617		11,607
Deferred income tax	7,947			7,947
Total liabilities	333,433	698,849	(82,303)	949,979
EQUITY				
Total shareholders' equity (deficit)	315,155	(39,889)		275,266
Noncontrolling interest (deficit)		(17,958)		(17,958)
Total liabilities and equity	648,588	641,002	(82,303)	1,207,287

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MERCER INTERNATIONAL INC.
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(In thousands of Euros, except per share data)

Note 12. Restricted Group Supplemental Disclosure (continued)**Combined Condensed Balance Sheets**

	December 31, 2010			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
ASSETS				
Current assets				
Cash and cash equivalents	50,654	48,368		99,022
Receivables	70,865	50,844		121,709
Inventories	60,910	41,309		102,219
Prepaid expenses and other	6,840	4,520		11,360
Deferred income tax	22,570			22,570
Total current assets	211,839	145,041		356,880
Long-term assets				
Property, plant and equipment	362,274	484,493		846,767
Deferred note issuance and other	6,903	4,179		11,082
Due from unrestricted group	80,582		(80,582)	
Note receivable	1,346			1,346
Total assets	662,944	633,713	(80,582)	1,216,075
LIABILITIES				
Current liabilities				
Accounts payable and accrued expenses	44,015	40,858		84,873
Pension and other post-retirement benefit obligations	728			728
Debt	16,429	23,167		39,596
Total current liabilities	61,172	64,025		125,197
Long-term liabilities				
Debt	273,473	508,855		782,328
Due to restricted group		80,582	(80,582)	
Unrealized interest rate derivative losses		50,973		50,973
Pension and other post-retirement benefit obligations	24,236			24,236
Capital leases and other	7,154	4,856		12,010
Deferred income tax	7,768			7,768
Total liabilities	373,803	709,291	(80,582)	1,002,512

EQUITY

Total shareholders' equity (deficit)	289,141	(53,073)		236,068
Noncontrolling interest (deficit)		(22,505)		(22,505)
Total liabilities and equity	662,944	633,713	(80,582)	1,216,075

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MERCER INTERNATIONAL INC.
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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 March 31, 2011			Consolidated Group
	Restricted Group	Unrestricted Subsidiaries	Eliminations	
Revenues				
Pulp	115,226	95,232		210,458
Energy	5,846	7,831		13,677
	121,072	103,063		224,135
Operating costs	85,991	77,364		163,355
Operating depreciation and amortization	7,614	6,462		14,076
Selling, general and administrative expenses and other	6,191	3,869		10,060
	99,796	87,695		187,491
Operating income (loss)	21,276	15,368		36,644
Other income (expense)				
Interest expense	(7,273)	(9,851)	1,218	(15,906)
Investment income (loss)	1,279	266	(1,218)	327
Foreign exchange gain (loss) on debt	1,111			1,111
Gain (loss) on derivative instruments		12,243		12,243
Total other income (expense)	(4,883)	2,658		(2,225)
Income (loss) before income taxes	16,393	18,026		34,419
Income tax benefit (provision)	(524)	(295)		(819)
Net income (loss)	15,869	17,731		33,600
Less: net (income) loss attributable to noncontrolling interest		(4,547)		(4,547)
Net income (loss) attributable to common shareholders	15,869	13,184		29,053

	Three Months Ended March 31, 2010			Consolidated Group
	Restricted Group	Unrestricted Subsidiaries	Eliminations	
Revenues				

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Pulp	106,417	64,704		171,121
Energy	3,375	5,756		9,131
	109,792	70,460		180,252
Operating costs	81,665	58,744		140,409
Operating depreciation and amortization	7,213	6,511		13,724
Selling, general and administrative expenses and other	4,841	3,254		8,095
	93,719	68,509		162,228
Operating income (loss)	16,073	1,951		18,024
Other income (expense)				
Interest expense	(7,320)	(10,264)	1,161	(16,423)
Investment income (loss)	1,239	16	(1,161)	94
Foreign exchange gain (loss) on debt	(5,231)			(5,231)
Gain (loss) on extinguishment of debt	(929)			(929)
Gain (loss) on derivative instruments		(6,546)		(6,546)
Total other income (expense)	(12,241)	(16,794)		(29,035)
Income (loss) before income taxes	3,832	(14,843)		(11,011)
Income tax benefit (provision)	(161)	(43)		(204)
Net income (loss)	3,671	(14,886)		(11,215)
Less: net (income) loss attributable to noncontrolling interest		3,669		3,669
Net income (loss) attributable to common shareholders	3,671	(11,217)		(7,546)

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MERCER INTERNATIONAL INC.
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(In thousands of Euros, except per share data)

Note 12. Restricted Group Supplemental Disclosure (continued)**Combined Condensed Statements of Cash Flows**

	Three Months Ended March 31, 2011		
	Restricted Group	Unrestricted Group	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss) attributable to common shareholders	15,869	13,184	29,053
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities			
Loss (gain) on derivative instruments		(12,243)	(12,243)
Foreign exchange (gain) loss on debt	(1,111)		(1,111)
Depreciation and amortization	7,676	6,462	14,138
Accretion expense (income)	470		470
Noncontrolling interest		4,547	4,547
Stock compensation expense	2,068		2,068
Pension and other post-retirement expense, net of funding	(14)		(14)
Other	133	551	684
Changes in current assets and liabilities			
Receivables	6,259	918	7,177
Inventories	(251)	4,564	4,313
Accounts payable and accrued expenses	10,962	14,426	25,388
Other ⁽¹⁾	(1,722)	2,081	359
Net cash from (used in) operating activities	40,339	34,490	74,829
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(5,708)	(2,361)	(8,069)
Proceeds on sale of property, plant and equipment	3	350	353
Notes receivable	396		396
Net cash from (used in) investing activities	(5,309)	(2,011)	(7,320)
Cash flows from (used in) financing activities			
Repayment of notes payable and debt	(15,768)	(14,583)	(30,351)
Repayment of capital lease obligations	(522)	(333)	(855)
Proceeds from (repayment of) credit facilities, net	(14,652)		(14,652)
Proceeds from government grants	4,004	108	4,112
Net cash from (used in) financing activities	(26,938)	(14,808)	(41,746)
Effect of exchange rate changes on cash and cash equivalents	(1,544)		(1,544)

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Net increase (decrease) in cash and cash equivalents	6,548	17,671	24,219
Cash and cash equivalents, beginning of period	50,654	48,368	99,022
Cash and cash equivalents, end of period	57,202	66,039	123,241

(1) Includes intercompany working capital related transactions.

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MERCER INTERNATIONAL INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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Note 12. Restricted Group Supplemental Disclosure (continued)**Combined Condensed Statements of Cash Flows**

	Three Months Ended March 31, 2010		
	Restricted Group	Unrestricted Group	Consolidated Group
Cash flows from (used in) operating activities			
Net income (loss) attributable to common shareholders	3,671	(11,217)	(7,546)
Adjustments to reconcile net income (loss) attributable to common shareholders to cash flows from operating activities			
Loss (gain) on derivative instruments		6,546	6,546
Foreign exchange loss (gain) on debt	5,231		5,231
Loss (gain) on extinguishment of debt	929		929
Depreciation and amortization	7,310	6,511	13,821
Accretion expense (income)	431		431
Noncontrolling interest		(3,669)	(3,669)
Stock compensation expense	506		506
Pension and other post-retirement expense, net of funding	194		194
Other	388	615	1,003
Changes in current assets and liabilities			
Receivables	(16,382)	(762)	(17,144)
Inventories	(193)	(5,066)	(5,259)
Accounts payable and accrued expenses	(2,845)	10,800	7,955
Other ⁽¹⁾	1,062	(2,343)	(1,281)
Net cash from (used in) operating activities	302	1,415	1,717
Cash flows from (used in) investing activities			
Purchase of property, plant and equipment	(4,927)	(923)	(5,850)
Proceeds on sale of property, plant and equipment	54	333	387
Note receivable	(84)		(84)
Net cash from (used in) investing activities	(4,957)	(590)	(5,547)
Cash flows from (used in) financing activities			
Repayment of notes payable and debt		(8,250)	(8,250)
Repayment of capital lease obligations	(382)	(622)	(1,004)
Proceeds from government investment grants	9,415		9,415
Net cash from (used in) financing activities	9,033	(8,872)	161
Effect of exchange rate changes on cash and cash equivalents	1,070		1,070
Net increase (decrease) in cash and cash equivalents	5,448	(8,047)	(2,599)
Cash and cash equivalents, beginning of period	20,635	30,656	51,291

Cash and cash equivalents, end of period	26,083	22,609	48,692
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(1) Includes intercompany working capital related transactions.

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

In this document: (i) unless the context otherwise requires, references to we, our, us, the Company or Mercer International Inc. and its subsidiaries; (ii) references to Mercer Inc. mean the Company excluding its subsidiaries; (iii) information is provided as of March 31, 2011, 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; and (vii) MW refers to megawatts and 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 months ended March 31, 2011 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, 2010 filed with the Securities and Exchange Commission (the SEC).

Current Market Environment

During the first quarter of 2011, the global market for NBSK pulp remained well balanced, and NBSK pulp prices remained at historically high levels. However, price increases in the quarter were largely offset by the weakening of the U.S. dollar. Looking ahead into 2011, we currently expect demand/supply conditions to result in a continued favorable outlook for our business.

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Selected production, sales and exchange rate data for the three months ended March 31, 2011 and 2010 is as follows:

	Three Months Ended March 31,	
	2011	2010
Pulp Production (000 ADMTs)	358.6	329.5
Scheduled Production Downtime (000 ADMTs)	3.7	18.2
Pulp Sales (000 ADMTs)	349.0	332.9
Pulp Revenues (in millions)	210.5	171.1
NBSK pulp list prices in Europe (\$/ADMT)	\$ 960	\$ 860
NBSK pulp list prices in Europe (/ADMT)	702	621
Average pulp sales realizations (/ADMT)	593	507
Energy Production (000 MWh)	407.8	337.7
Energy Sales (000 MWh)	157.9	107.1
Energy Revenue (in millions)	13.7	9.1
Average energy sales realizations (/MWh)	87	85
Average Spot Currency Exchange Rates		
/(\$)	0.7304	0.7240
C\$ / \$(²)	0.9856	1.0401
C\$ / (³)	1.3487	1.4406

(1) Average realized pulp prices for the periods indicated reflect customer discounts and pulp price movements between the order and shipment date.

(2) Average Federal Reserve Bank of New York noon spot rate over the reporting period.

(3) Average Bank of Canada noon spot rates over the reporting period.

Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010

Total revenues for the three months ended March 31, 2011 increased to 224.1 million (\$306.6 million) from 180.3 million (\$249.5 million) in the same period in 2010.

Pulp revenues for the three months ended March 31, 2011 increased by approximately 23% to 210.5 million from 171.1 million in the comparative quarter of 2010, primarily due to higher pulp prices, being partially offset by a weaker U.S. dollar. Revenues from the sale of excess energy increased by approximately 51% to a record 13.7 million in the first quarter from 9.1 million in the same quarter last year, primarily as a result of energy sales from the Celgar Green Energy Project in 2011.

Pulp prices in the first quarter of 2011 were higher than in the same period last year due to the continued strengthening in global pulp markets. List prices for NBSK pulp in Europe were approximately \$960 (702) per ADMT in the current quarter compared to approximately \$860 (621) per ADMT in the first quarter of 2010 and \$950 (709) at the end of 2010. In the first quarter of 2011, average pulp sales realizations increased by approximately 17% to 593 per ADMT from 507 per ADMT in the same period last year, primarily due to higher pulp prices.

Pulp production increased to 358,557 ADMTs in the current quarter from 329,455 ADMTs in the same quarter of 2010, primarily due to only two days of scheduled maintenance downtime at our Stendal mill in the current quarter, compared to ten days at Stendal in the first quarter of 2010.

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We have ten days (approximately 15,000 ADMTs) of scheduled maintenance downtime planned for our Celgar mill in the second quarter of 2011.

Pulp sales volume increased to 348,995 ADMTs in the current quarter from 332,869 ADMTs in the comparative period of 2010, primarily as a result of stronger demand.

Costs and expenses in the first quarter of 2011 increased to 187.5 million from 162.2 million in the comparative period of 2010, primarily due to higher fiber costs.

In the first quarter of 2011, operating depreciation and amortization increased slightly to 14.1 million from 13.7 million in the same quarter last year. Selling, general and administrative expenses increased to 10.2 million from 8.1 million in the first quarter of 2010, primarily as a result of a higher non-cash stock compensation expense resulting from a higher share price.

Transportation costs increased to 15.5 million in the first quarter of 2011 from 14.2 million in the first quarter of 2010, primarily due to higher container rates and fuel costs.

On average, our per unit fiber costs in the quarter increased by approximately 20% from the same period in 2010, primarily due to low harvesting activity in Germany as a result of the downturn in the lumber industry which has been compounded by demand for fiber from the European wood pellet and particle board industries. As a result, our German mills have been required to source fiber outside their traditional fiber baskets. We currently expect our overall fiber costs to remain stable at these levels in the short- to mid-term.

For the first quarter of 2011, operating income increased by approximately 103% to 36.6 million from 18.0 million in the comparative quarter of 2010, primarily due to significantly higher pulp prices.

Interest expense in the first quarter of 2011 decreased to 15.9 million from 16.4 million in the comparative quarter of 2010, primarily due to reduced levels of debt associated with the Stendal mill.

Our Stendal mill recorded an unrealized gain of 12.2 million on the mark to market of its interest rate derivatives in the current quarter, compared to an unrealized loss of 6.5 million in the same quarter of last year. We recorded a foreign exchange gain of 1.1 million on our foreign currency denominated debt in the first quarter of 2011 compared to a foreign exchange loss of 5.2 million in the same period of 2010.

During the current quarter, we recorded 0.8 million of net income tax expense, compared to net income tax expense of 0.2 million in the same period last year.

In the first quarter of 2011, the noncontrolling shareholder's interest in the Stendal mill's income was 4.5 million, compared to a loss of 3.7 million in the same quarter last year.

We reported net income attributable to common shareholders of 29.1 million, or 0.66 per basic and 0.52 per diluted share for the first quarter of 2011, which included aggregate non-cash unrealized gains of 12.2 million on the Stendal interest rate derivatives and a 1.1 million non-cash foreign exchange gain on our debt, partially offset by a non-cash charge for stock compensation of 2.1 million. In the first quarter of 2010, the net loss attributable to common shareholders was 7.5 million, or 0.21 per basic and diluted share, which included non-cash unrealized losses of 6.5 million on the Stendal interest rate derivatives and a non-cash foreign exchange loss of 5.2 million on our debt.

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Operating EBITDA in the first quarter of 2011 was 50.8 million, compared to 31.8 million in the first quarter of 2010. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. Management uses Operating EBITDA as a benchmark measurement of its own operating results, and as a benchmark relative to its competitors. Management considers it to be a meaningful supplement to operating income as a performance measure primarily because depreciation expense and non-recurring capital asset impairment charges are not an actual cash cost, and depreciation expense varies widely from company to company in a manner that management considers largely independent of the underlying cost efficiency of their operating facilities. In addition, we believe Operating EBITDA is commonly used by securities analysts, investors and other interested parties to evaluate our financial performance.

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

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

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

	Three Months Ended	
	March 31,	
	2011	2010
	(in thousands)	
Net income (loss) attributable to common shareholders	29,053	(7,546)
Net income (loss) attributable to noncontrolling interest	4,547	(3,669)
Income taxes (benefits)	819	204
Interest expense	15,906	16,423
Investment (income) loss	(327)	(94)
Foreign exchange (gain) loss on debt	(1,111)	5,231
Loss (gain) on extinguishment of debt		929
Loss (gain) on derivative instruments	(12,243)	6,546
Operating income (loss)	36,644	18,024
Add: Depreciation and amortization	14,138	13,821
Operating EBITDA	50,782	31,845

Liquidity and Capital Resources

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

	March 31,	December 31,
	2011	2010
	(in thousands)	
Financial Position		
Cash and cash equivalents	123,241	99,022
Working capital	210,980	231,683
Property, plant and equipment	830,095	846,767
Total assets	1,207,287	1,216,075
Long-term liabilities	795,118	877,315
Total equity	257,308	213,563

As at March 31, 2011, our cash and cash equivalents had increased to 123.2 million from 99.0 million at the end of 2010, and working capital had decreased to 211.0 million from 231.7 million at the end of 2010.

Sources and Uses of Funds

Our principal sources of funds are cash flows from operations, cash on hand and the revolving working capital loan facilities for our Celgar and Rosenthal mills. Our principal uses of funds consist of operating expenditures, payments of principal and interest on the project loan facility relating to our Stendal mill (Stendal Loan Facility), capital expenditures and interest payments on our outstanding 9.5% senior notes due 2017 (the Senior Notes) and our 8.5% convertible senior subordinated notes due 2012.

During the first quarter of 2011, we redeemed all of our previously outstanding 9.25% senior notes due 2013 and repaid approximately C\$20.0 million of principal under our Celgar loan facility.

At March 31, 2011, our Celgar mill had approximately C\$4.7 million of grant monies related to holdbacks that we expect to receive in the second half of 2011 from the Government of Canada in regard to the completion of the Celgar Energy Project. Additionally, in March 2011, the Company finalized a contribution agreement with Natural Resources Canada, or NRCan , for approximately C\$9.7 million of unallocated Green Transformation Program or GTP funds to be used towards improving the fiber line and oxygen delignification process at the Celgar mill. As of April 2011, the

Company has received approximately C\$3.8 million of such funds.

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During the first quarter of 2011, the Company finalized a contribution agreement under the Government of Canada's Transformative Technology Program to fund approximately 50% of the capital cost associated with the installation of our generator acid purification system at our Celgar mill. We expect to receive approximately C\$1.6 million (1.2 million) from the Canadian government related to this project.

Debt Covenants

Our long-term obligations contain various financial tests and covenants customary to these types of arrangements. As at March 31, 2011, we were in compliance with all of the covenants of our indebtedness.

Cash Flow Analysis

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

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

Cash provided by operating activities increased to 74.8 million in the three months ended March 31, 2011 from 1.7 million in the same period of 2010, primarily due to significantly higher net income and an increase in accounts payable and accrued expenses. A decrease in receivables provided cash of 7.2 million in the first three months of 2011, compared to an increase in receivables using cash of 17.1 million in the first three months of 2010. A decrease in inventories provided cash of 4.3 million in the first three months of 2011, compared to an increase in inventories using cash of 5.3 million in the first three months of 2010. An increase in accounts payable and accrued expenses provided cash of 25.4 million in the first three months of 2011, compared to an increase in accounts payable and accrued expenses providing cash of 8.0 million, in the first three months of 2010.

Cash Flows from Investing Activities. Investing activities in the first three months of 2011 used cash of 7.3 million, compared to using cash of 5.5 million in the same period of 2010. Capital expenditures in the first three months of 2011 used cash of 8.1 million, compared to 5.9 million in the same period of 2010.

Cash Flows from Financing Activities. In the first three months of 2011, financing activities used cash of 41.7 million, compared to providing cash of 0.2 million in the same period last year, primarily as a result of cash used to redeem our 9.25% senior notes due 2013, to repay 14.6 million of the principal under the Stendal Loan Facility and to repay 14.7 million of borrowings under the revolving facility at our Celgar mill. Repayment of indebtedness used cash of 30.4 million in the three months ended March 31, 2011, compared to using cash of 8.3 million in the three months ended March 31, 2010.

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Capital Resources

We have no material commitments to acquire assets or operating businesses.

Future Liquidity

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

Contractual Obligations and Commitments

There were no material changes outside the ordinary course to any of our material contractual obligations during the first three months of 2011.

Foreign Currency

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

We translate foreign denominated assets and liabilities into Euros at the rate of exchange on the balance sheet date. Unrealized gains or losses from these translations are recorded in our consolidated statement of comprehensive income and impact on shareholders' equity on the balance sheet but do not affect our net earnings.

In the three months ended March 31, 2011, accumulated other comprehensive income increased by \$3.7 million to \$35.5 million, primarily due to the foreign exchange translation.

Based upon the exchange rate at March 31, 2011, the U.S. dollar has weakened by approximately 5% in value against the Euro since March 31, 2010. 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 12 of our Interim Consolidated Financial Statements included herein.

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Restricted Group Results Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010

Total revenues for the Restricted Group increased to 121.1 million (\$165.7 million) in the first quarter of 2011, compared to 109.8 million (\$152.0 million) in the first quarter of 2010.

Pulp revenues for the Restricted Group for the three months ended March 31, 2011 increased by approximately 8% to 115.2 million from 106.4 million in the comparative period of 2010, primarily due to higher pulp prices, partially offset by a weaker U.S. dollar. Revenues from the sale of excess energy increased by approximately 71% in the current quarter to a record 5.8 million from 3.4 million in the same period last year, primarily due to energy sales from the Celgar energy project in 2011.

Pulp prices were higher in the first quarter of 2011 than in the same period last year due to continued strengthening in global pulp markets. List prices for NBSK pulp in Europe were approximately \$960 (702) per ADMT in the current quarter compared to approximately \$860 (621) per ADMT in the first quarter of 2010. In the first quarter of 2011, average pulp sales realizations for the Restricted Group increased by approximately 16% to 596 per ADMT from 513 per ADMT in the same period last year.

Pulp production for the Restricted Group decreased slightly to 204,306 ADMTs in the first quarter of 2011 from 210,336 ADMTs in the same period of 2010, primarily as a result of minor temporary equipment failures adversely affecting production at our Celgar mill.

Pulp sales volume of the Restricted Group decreased slightly to 193,236 ADMTs in the first quarter of 2011 from 207,431 ADMTs in the comparative period of 2010, primarily due to lower production levels at our Celgar mill.

Costs and expenses for the Restricted Group in the first quarter of 2011 increased to 99.8 million from 93.7 million in the comparative period of 2010, primarily due to higher fiber costs at our Rosenthal mill.

In the first quarter of 2011, operating depreciation and amortization for the Restricted Group increased to 7.6 million from 7.2 million in the same period last year. Selling, general and administrative expenses and other for the Restricted Group increased to 6.2 million from 4.8 million in the comparative period of 2010, primarily as a result of a higher non-cash stock compensation expense resulting from a higher share price.

Transportation costs for the Restricted Group were unchanged at 11.2 million in the first quarter of 2011 and the same quarter last year.

Overall, per unit fiber costs of the Restricted Group in the first quarter of 2011 increased by approximately 16% compared to the same period in 2010, primarily due to higher fiber costs at our Rosenthal mill, mainly due to continued low harvesting rates in Germany and high demand from both the European wood pellet and particle board industries.

In the first quarter of 2011, the Restricted Group reported operating income of 21.3 million compared to operating income of 16.1 million in the first quarter of 2010, primarily due to significantly higher pulp price realizations.

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Interest expense for the Restricted Group remained unchanged at approximately 7.3 million in the first quarter of this year and last year.

In the first quarter of 2011, the Restricted Group recorded a foreign exchange gain on foreign currency denominated debt of 1.1 million, compared to a loss on foreign currency denominated debt of 5.2 million in the comparative quarter of 2010.

During the first quarter of 2011, the Restricted Group recorded 0.5 million of net income tax expense, compared to net income tax expense of 0.2 million in the same period last year.

The Restricted Group reported net income for the first quarter of 2011 of 15.9 million compared to net income of 3.7 million in the same period last year.

In the first quarter of 2011, the Restricted Group reported Operating EBITDA of 29.0 million compared to Operating EBITDA of 23.4 million in the comparative quarter of 2010. Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our results for the three months ended March 31, 2011 for additional information relating to such limitations and Operating EBITDA.

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

	Three Months Ended	
	March 31,	
	2011	2010
	(in thousands)	
Restricted Group⁽¹⁾		
Net income (loss)	15,869	3,671
Income taxes (benefits)	524	161
Interest expense	7,273	7,320
Investment (income) loss	(1,279)	(1,239)
Foreign exchange (gain) loss on debt	(1,111)	5,231
Loss (gain) on extinguishment of debt		929
Operating income (loss)	21,276	16,073
Add: Depreciation and amortization	7,676	7,310
Operating EBITDA	28,952	23,383

(1) See Note 12 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results.

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

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

	March 31, 2011	December 31, 2010
	(in thousands)	
Restricted Group Financial Position⁽¹⁾		
Cash and cash equivalents	57,202	50,654
Working capital	127,551	150,667
Property, plant and equipment	350,034	362,274
Total assets	648,588	662,944
Long-term liabilities	252,060	312,631
Total equity	315,155	289,141

(1) See Note 12 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results.

At March 31, 2011, cash and cash equivalents for the Restricted Group increased to 57.2 million from 50.7 million at the end of 2010.

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

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect both the amount and the timing of the recording of assets, liabilities, revenues, and expenses in the consolidated financial statements and accompanying note 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, 2010. 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, 2010.

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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, es, words of similar meaning, or future or conditional verbs, such as will, should, could, or may, although not forward-looking statements contain these identifying words. Forward-looking statements are 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;
- in a weak pulp price and demand environment there can be no assurance that we will be able to generate sufficient cash flows, to service, repay or refinance debt;
- 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 has caused significant fluctuations in our operating results;
- we are subject to extensive environmental regulation and we could have environmental liabilities at our facilities;
- our Celgar energy project may not generate the results or benefits 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;

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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, 2010. We advise you that these cautionary remarks expressly qualify in their entirety all forward-looking statements attributable to us or persons acting on our behalf. Unless required by law, we do not assume any obligation to update forward-looking statements based on unanticipated events or changed expectations. However, you should carefully review the reports and other documents we file from time to time with the SEC.

Cyclical Nature of Business

Revenues

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

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

Demand for pulp has historically been determined by the level of economic growth and has been closely tied to overall business activity. From 2006 to mid-2008, pulp prices in Europe steadily improved. However, in the latter half of 2008, a global economic crisis resulted in a sharp decline of European pulp prices from a high of \$900 per ADMT to \$635 per ADMT at the end of 2008. Beginning in the second quarter of 2009 prices began to improve, rising from a low of \$575 per ADMT in March 2009 to \$980 per ADMT at the end of the second quarter of 2010. European list pulp prices remained at historically high levels through the first quarter of 2011, and reached a record of \$1,010 per ADMT in April 2011.

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

Costs

Our production costs are influenced by the availability and cost of raw materials, energy and labor, and our plant efficiencies and productivity. Our main raw material is fiber in the form of wood chips and pulp logs. Fiber costs are primarily affected by the supply of, and demand for, lumber which is highly cyclical in nature and can vary significantly by location. The state of lumber markets affects both the amount of wood residuals, such as chips, produced as a by-product of lumber and the level of timber harvesting, which provides us with pulp logs. Production costs also depend on the total volume of production. Lower operating rates and production efficiencies during periods of cyclically low demand result in higher average production costs and lower margins.

Currency

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

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

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

During the first three months of 2011, we recorded an unrealized gain of \$12.2 million on our outstanding interest rate derivatives compared to an unrealized loss of \$6.5 million in the comparative period of 2010.

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

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ITEM 4. CONTROLS AND PROCEDURES

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

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

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

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to routine litigation incidental to our business, including those described in our latest annual report on Form 10-K for the fiscal year ended December 31, 2010. 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

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, 2010.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit

No.

Description

31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1*	Section 906 Certification of Chief Executive Officer
32.2*	Section 906 Certification of Chief Financial Officer

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

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SIGNATURES

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

MERCER INTERNATIONAL INC.

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

Date: May 9, 2011
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