

MERCER INTERNATIONAL INC.

Form 10-Q

August 09, 2007

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 **June 30, 2007**

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 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

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 36,285,027 shares of common stock outstanding as at August 7, 2007.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MERCER INTERNATIONAL INC.

CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED JUNE 30, 2007

(Unaudited)

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MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
As at June 30, 2007 and December 31, 2006
(Unaudited)
(Euros in thousands)

	June 30, 2007	December 31, 2006
ASSETS		
Current Assets		
Cash and cash equivalents	48,302	69,367
Receivables	104,494	75,022
Note receivable, current portion	5,834	7,798
Inventories (Note 4)	94,891	62,857
Prepaid expenses and other	5,462	4,662
Current assets of discontinued operations (Note 10)	1,104	2,094
Total current assets	260,087	221,800
Long-Term Assets		
Cash restricted	45,000	57,000
Property, plant and equipment	968,830	972,143
Investments	88	1
Unrealized foreign exchange rate derivative gain		5,933
Deferred note issuance and other costs	6,294	6,984
Deferred income tax	18,670	29,989
Note receivable, less current portion	4,506	8,744
	1,043,388	1,080,794
Total assets	1,303,475	1,302,594
LIABILITIES		
Current Liabilities		
Accounts payable and accrued expenses	100,970	84,173
Debt, current portion	33,364	33,903
Current liabilities of discontinued operations (Note 10)	651	1,926
Total current liabilities	134,985	120,002
Long-Term Liabilities		
Debt, less current portion (Note 8)	848,990	873,928
Unrealized interest rate derivative loss	17,570	41,355
Pension and other post-retirement benefit obligations (Note 6)	18,940	17,954
Capital leases	6,457	6,202
Deferred income tax	24,565	22,911

Other long-term liabilities	3,617	1,441
	920,139	963,791
Total liabilities	1,055,124	1,083,793
Minority Interest		
SHAREHOLDERS EQUITY		
Common shares (Note 8)	202,626	195,642
Additional paid-in capital	134	154
Retained earnings	19,485	15,240
Accumulated other comprehensive income	26,106	7,765
Total shareholders equity	248,351	218,801
Total liabilities and shareholders equity	1,303,475	1,302,594

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

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MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
For Six Months Ended June 30, 2007 and 2006
(Unaudited)
(Euros in thousands, except for loss per share)

	2007	2006
Revenues	346,134	292,262
Costs and expenses		
Operating costs	277,555	239,292
Operating depreciation and amortization	27,719	28,325
	40,860	24,645
General and administrative expenses	16,206	16,314
(Sale) purchase of emission allowances	(766)	(13,246)
Operating income from continuing operations	25,420	21,577
Other income (expense)		
Interest expense	(37,709)	(45,728)
Investment income	3,195	3,003
Unrealized foreign exchange gain on debt	2,603	12,173
Realized gain (loss) on derivative instruments (Note 5)	6,820	(5,219)
Unrealized gain on derivative instruments (Note 5)	17,852	90,724
Total other (expense) income	(7,239)	54,953
Income before income taxes and minority interest from continuing operations	18,181	76,530
Income tax provision	(13,705)	(42,920)
Income before minority interest from continuing operations	4,476	33,610
Minority interest	(43)	898
Net income from continuing operations	4,433	34,508
Net (loss) income from discontinued operations	(188)	501
Net income	4,245	35,009
Retained earnings (deficit), beginning of period	15,240	(47,970)
Retained earnings (deficit), end of period	19,485	(12,961)
Net income per share from continuing operations (Note 3)		
Basic	0.12	1.04

Diluted	0.12	0.85
Income per share		
Basic	0.12	1.06
Diluted	0.12	0.86

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

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MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
For Three Months Ended June 30, 2007 and 2006
(Unaudited)
(Euros in thousands, except for loss per share)

	2007	2006
Revenues	176,603	150,594
Costs and expenses		
Operating costs	142,808	124,385
Operating depreciation and amortization	13,990	14,637
	19,805	11,572
General and administrative expenses	8,901	8,597
(Sale) purchase of emission allowances	(39)	(7,608)
Operating income from continuing operations	10,943	10,583
Other income (expense)		
Interest expense	(17,641)	(22,914)
Investment income	1,584	1,263
Unrealized foreign exchange gain on debt	1,349	6,060
Realized loss on derivative instruments (Note 5)		(1,657)
Unrealized gain on derivative instruments (Note 5)	18,100	46,347
Total other income	3,392	29,099
Income before income taxes and minority interest from continuing operations	14,335	39,682
Income tax provision	(9,904)	(21,807)
Income before minority interest from continuing operations	4,431	17,875
Minority interest	(1,091)	449
Net income from continuing operations	3,340	18,324
Net (loss) income from discontinued operations	(181)	97
Net income	3,159	18,421
Retained earnings (deficit), beginning of period	16,326	(31,382)
Retained earnings (deficit), end of period	19,485	(12,961)
Net income per share from continuing operations (Note 3)		
Basic	0.09	0.55

Diluted	0.09	0.45
Income per share		
Basic	0.09	0.56
Diluted	0.09	0.45

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

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MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
For Six Months Ended June 30, 2007 and 2006
(Unaudited)
(Euros in thousands)

	2007	2006
Net income	4,245	35,009
Other comprehensive income:		
Foreign currency translation adjustment	18,254	5,360
Pension plan additional minimum liability		(17)
Unrealized gains on securities		
Unrealized holding gains arising during the period	87	690
Other comprehensive income	18,341	6,033
Total comprehensive income	22,586	41,042

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

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MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
For Three Months Ended June 30, 2007 and 2006
(Unaudited)
(Euros in thousands)

	2007	2006
Net income	3,159	18,421
Other comprehensive income:		
Foreign currency translation adjustment	16,350	8,345
Pension plan additional minimum liability		2
Unrealized gains on securities		
Unrealized holding gains arising during the period	85	569
Other comprehensive income	16,435	8,916
Total comprehensive income	19,594	27,337

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

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MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
For Six Months Ended June 30, 2007 and 2006
(Unaudited)
(Euros in thousands)

	2007	2006
Cash Flows (used in) from Operating Activities:		
Net income	4,245	35,009
Adjustments to reconcile net loss to cash flows from operating activities		
Unrealized gains on derivatives	(17,852)	(85,505)
Unrealized foreign exchange gain on debt	(2,603)	(12,173)
Operating depreciation and amortization	27,719	28,944
Non-operating amortization	128	138
Minority interest	43	(898)
Deferred income taxes	12,972	42,567
Stock compensation expense	196	207
Pension and other post-retirement expense	955	871
Other	924	(979)
Changes in current assets and liabilities		
Receivables	(26,721)	(13,486)
Inventories	(29,670)	10,670
Accounts payable and accrued expenses	15,129	(3,347)
Other	1,280	(252)
Net cash (used in) from operating activities	(13,255)	1,766
Cash Flows from (used in) Investing Activities:		
Cash restricted	12,000	(40,817)
Purchase of property, plant and equipment	(10,537)	(15,439)
Proceeds on sale of property, plant and equipment	527	526
Notes receivable	4,731	
Pension and other post-retirement benefit funding	(833)	(908)
Net cash from (used in) investing activities	5,888	(56,638)
Cash Flows (used in) from Financing Activities:		
Decrease in construction costs payable		(212)
Proceeds from borrowings of notes payable and debt		48,634
Repayment of notes payable and debt	(13,453)	(375)
Repayment of capital lease obligations	(2,576)	(2,431)
Issuance of shares of common stock	305	69
Net cash (used in) from financing activities	(15,724)	45,685
Effect of exchange rate changes on cash and cash equivalents	2,171	(1,281)

Net decrease in cash and cash equivalents	(20,920)	(10,468)
Cash and cash equivalents, beginning of period ⁽¹⁾	69,804	83,547
Cash and cash equivalents, end of period ⁽²⁾	48,884	73,079
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	17,624	42,309
Income taxes	615	1,128
Supplemental schedule of non-cash investing and financing activities:		
Acquisition of production and other equipment under capital lease obligations	2,215	2,123
Common shares issued in satisfaction of floating rate note	6,728	

(1) Includes amounts related to discontinued operations of: 2007 437, 2006 722 (Note 10)

(2) Includes amounts related to discontinued operations of: 2007 582, 2006 751 (Note 10)

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

MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2007

(Unaudited)

(Euros in thousands, except for shares and per share data)

Note 1. Basis of Presentation

Basis of Presentation

The interim period 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 the NASDAQ National Market and the Toronto Stock Exchange, respectively.

The interim period 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 condensed balance sheet data was derived from audited financial statements, but certain information and footnote disclosure normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such SEC rules and regulations. The interim period 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, 2006. In the opinion of the Company, the unaudited consolidated financial statements contained herein contain all adjustments necessary to present a fair statement of the results of the interim periods presented. The results for the periods presented herein may not be indicative of the results for the entire year.

New Accounting Standards

In February 2007, the FASB issued FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159). FAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value, with the objective of improving financial reporting by mitigating volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The provisions of FAS 159 are effective for the Company s year ending December 31, 2008. The Company is currently evaluating the impact that the adoption of this statement will have on the Company s consolidated financial position, results of operations and disclosures.

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MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2007
(Unaudited)

(Euros in thousands, except for shares and per share data)

Note 2. Stock-Based Compensation

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment*, on January 1, 2006. This statement requires the Company to recognize the cost of employee services received in exchange for the Company's equity instruments. Under SFAS No. 123R, the Company is required to record compensation expense over an award's vesting period based on the award's fair value at the date of grant. The Company has elected to adopt SFAS No. 123R on a modified prospective basis.

Stock Options

The Company has a non-qualified stock option plan which provides for options to be granted to officers and employees to acquire a maximum of 3,600,000 common shares including options for 130,000 shares to directors who are not officers or employees. During 2004, the Company adopted a stock incentive plan which provides for options, stock appreciation rights and restricted shares to be awarded to employees and outside directors to a maximum of 1,000,000 common shares.

Following is a summary of the status of options outstanding at June 30, 2007:

Exercise Price Range (In U.S. Dollars)	Outstanding Options			Exercisable Options	
	Number	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise price (In U.S. Dollars)	Number	Weighted Average Exercise Price (In U.S. Dollars)
\$5.65 - 6.375	830,000	3.00	\$ 6.29	830,000	\$ 6.29
8.50	135,000		8.50	135,000	8.50
7.30	30,000	8.00	7.30	20,000	7.30
7.92	68,334	8.25	7.92	40,000	7.92

During the six-month period ended June 30, 2007, 30,000 options were exercised at an exercise price of \$6.375 and 26,666 options were exercised at an exercise price of \$7.92 for cash proceeds of \$402,435. 5,000 options were cancelled during the period. The average intrinsic value of the options exercised was \$4.58 per option. During the six-month period ended June 30, 2006, no options were exercised or cancelled.

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MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2007

(Unaudited)

(Euros in thousands, except for shares and per share data)

Note 2. Stock-Based Compensation (cont d)

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 two years. Expense is recognized on a straight-line basis over the vesting period. Expense recognized for the six months ended June 30, 2007 and 2006 was 143 and 207, respectively.

As at June 30, 2007, the total remaining unrecognized compensation cost related to restricted stock amounted to 100, which will be amortized over their remaining vesting period.

During the six month period ended June 30, 2007, there were restricted stock awards granted of an aggregate of Nil (2006 10,000) of our common shares to independent directors and officers of the Company and Nil (2006 Nil) restricted stock awards were cancelled.

As at June 30, 2007, the total number of restricted stock awards outstanding was 190,686.

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MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2007

(Unaudited)

(Euros in thousands, except for shares and per share data)

Note 3. Income Per Share

	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Net income from continuing operations	4,433	34,508	3,341	18,324
Interest on convertible notes, net of tax		2,767		1,441
Net income from continuing operations diluted	4,433	37,275	3,341	19,765
Net income from continuing operations per share:				
Basic	0.12	1.04	0.09	0.55
Diluted	0.12	0.85	0.09	0.45
Net income from continuing operations	4,433	34,508	3,341	18,324
Net (loss) income from discontinued operations	(188)	501	(181)	97
Net income Basic	4,245	35,009	3,160	18,421
Interest on convertible notes, net of tax		2,767		1,441
Net income Diluted	4,245	37,776	3,160	19,862
Net income per share:				
Basic	0.12	1.06	0.09	0.56
Diluted	0.12	0.86	0.09	0.45
Weighted average number of common shares outstanding:				
Basic	35,873,800	33,169,637	36,256,472	33,170,129
Effect of dilutive shares:				
Stock options and awards	465,146	274,686	437,715	292,002
Convertible notes	9,428,022	10,645,161	9,428,022	10,645,161
Diluted	45,766,968	44,089,484	46,122,209	44,107,292

The calculation of diluted income per share does not assume the exercise of stock options and awards or the conversion of convertible notes when their effect would be anti-dilutive on earnings per share. Convertible notes excluded from the calculation of diluted income per share because they are anti-dilutive represented 9,428,022 and Nil for the six months ended June 30, 2007 and 2006, respectively.

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MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2007

(Unaudited)

(Euros in thousands, except for shares and per share data)

Note 4. Inventories

	June 30, 2007	December 31, 2006
Raw materials	66,886	38,905
Work in process and finished goods	28,005	23,952
	94,891	62,857

Note 5 . Derivatives Transactions

	Six Months Ended June 30,	
	2007	2006
Realized net gain (loss) on derivative financial instruments	6,820	(5,219)
Unrealized net gain on interest rate derivatives	23,786	36,326
Unrealized net (loss) gain on foreign exchange derivatives	(5,934)	54,398
Unrealized net gain on derivative financial instruments	17,852	90,724
	Three Months Ended June 30,	
	2007	2006
Realized net loss on derivative financial instruments		(1,657)
Unrealized net gain on interest rate derivatives	18,100	12,820
Unrealized net gain on foreign exchange derivatives		33,527
Unrealized net gain on derivative financial instruments	18,100	46,347

MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2007

(Unaudited)

(Euros in thousands, except for shares and per share data)

Note 6. 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 German pulp mills.

The largest component of this obligation is with respect to the Celgar mill which maintains defined benefit pension plans and post-retirement benefits plans for certain employees. Pension benefits are based on employees' earnings and years of service. The pension plans are funded by contributions from the Company based on actuarial estimates and statutory requirements. Pension contributions for the six month periods ended June 30, 2007 and June 30, 2006 totaled 833 and 908, respectively.

	Six Months Ended June 30,			
	2007		2006	
	Pension Benefits	Post-Retirement Benefits	Pension Benefits	Post-Retirement Benefits
Service cost	410	230	448	227
Interest cost	666	362	706	382
Expected return on plan assets	(815)		(786)	
Recognized net loss		31		50
Net periodic benefit cost	261	623	368	659

	Three Months Ended June 30,			
	2007		2006	
	Pension Benefits	Post-Retirement Benefits	Pension Benefits	Post-Retirement Benefits
Service cost	209	117	222	112
Interest cost	339	184	350	190
Expected return on plan assets	(415)		(389)	
Recognized net loss		16		25
Net periodic benefit cost	133	317	183	327

The Company anticipates that it will make contributions to the pension plan of approximately 1,418 in 2007.

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MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2007

(Unaudited)

(Euros in thousands, except for shares and per share data)

Note 7. Income Taxes

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*, and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no adjustment in the liability for unrecognized tax benefits.

As at the adoption date of January 1, 2007, the Company had approximately 18.6 million of total gross unrecognized tax benefits, substantially all of which would affect our effective tax rate if recognized.

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense. During the year ended December 31, 2006, the Company recognized approximately Nil in penalties and interest. The Company had Nil for the payment of interest and penalties accrued at December 31, 2006. Upon adoption of FIN 48 on January 1, 2007, the Company had no change in its accrual for interest and penalties from Nil.

The Company and/or one or more of its subsidiaries file income tax returns in the United States, Germany and Canada. The Company is generally not subject to U.S., German or Canadian income tax examinations for tax years before 2003, 2001 and 2004, respectively.

Note 8. Common Shares

At June 30, 2007, the Company had outstanding 36,256,472 common shares with a par value of \$1.00 per share (June 30, 2006 33,170,129 shares).

On March 30, 2007, under the terms of a note payable to a third party, the Company at its sole option satisfied the principal amount of the note of 6,728 by issuing 742,185 common shares of the Company. The value of the shares paid was determined based on the 20-day trading day average closing price for the Company's shares which was \$12.09. The accrued interest outstanding on the note of 115 was paid on this date.

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MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2007

(Unaudited)

(Euros in thousands, except for shares and per share data)

Note 9. Restricted Group Supplemental Disclosure

The terms of the indenture governing our 9.25% senior unsecured notes requires 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 six months ended June 30, 2007 and 2006, 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 and up to December 31, 2006 the discontinued paper operations.

Combined Condensed Balance Sheet

	June 30, 2007			
	Restricted Group	Unrestricted Subsidiary	Eliminations	Consolidated Group
ASSETS				
Current assets				
Cash and cash equivalents	40,027	8,275		48,302
Receivables	50,159	54,335		104,494
Note receivable, current portion	617	5,217		5,834
Inventories	57,306	37,585		94,891
Prepaid expenses and other	2,445	3,017		5,462
Current assets from discontinued operations	1,104			1,104
Total current assets	151,658	108,429		260,087
Cash restricted		45,000		45,000
Property, plant and equipment	397,577	571,253		968,830
Other	6,382			6,382
Deferred income tax	11,715	6,955		18,670
Due from unrestricted group	56,540		(56,540)	
Note receivable, less current portion	4,506			4,506
Total assets	628,378	731,637	(56,540)	1,303,475
LIABILITIES				
Current				
Accounts payable and accrued expenses	52,366	48,604		100,970
Debt, current portion		33,364		33,364
Current liabilities from discontinued operations	651			651
Total current liabilities	53,017	81,968		134,985
Debt, less current portion	291,556	557,434		848,990
Due to restricted group		56,540	(56,540)	
Unrealized derivative loss		17,570		17,570
Capital leases	4,520	1,937		6,457
Deferred income tax	4,125	20,440		24,565

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Other long-term liabilities	22,544	13		22,557
Total liabilities	375,762	735,902	(56,540)	1,055,124
SHAREHOLDERS EQUITY				
Total shareholders equity (deficit)	252,616	(4,265)		248,351
Total liabilities and shareholders equity	628,378	731,637	(56,540)	1,303,475

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MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2007

(Unaudited)

(Euros in thousands, except for shares and per share data)

Note 9. Restricted Group Supplemental Disclosure (cont d)

Combined Condensed Balance Sheet

	December 31, 2006			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
ASSETS				
Current				
Cash and cash equivalents	39,078	30,289		69,367
Receivables	38,662	36,360		75,022
Note receivable, current portion	620	7,178		7,798
Inventories	41,087	21,770		62,857
Prepaid expenses and other	2,352	2,310		4,662
Current assets of discontinued operations		2,094		2,094
Total current assets	121,799	100,001		221,800
Cash restricted		57,000		57,000
Property, plant and equipment	408,957	563,186		972,143
Other	8,155	4,763		12,918
Deferred income tax	14,316	15,673		29,989
Due from unrestricted group	51,265		(51,265)	
Note receivable, less current portion	5,023	3,721		8,744
Total assets	609,515	744,344	(51,265)	1,302,594
LIABILITIES				
Current				
Accounts payable and accrued expenses	46,838	37,335		84,173
Debt, current portion		33,903		33,903
Current liabilities from discontinued operations		1,926		1,926
Total current liabilities	46,838	73,164		120,002
Debt, less current portion	293,781	580,147		873,928
Due to restricted group		51,265	(51,265)	
Unrealized derivative loss		41,355		41,355
Capital leases	2,720	3,482		6,202
Deferred income tax	2,832	20,079		22,911
Other long-term liabilities	19,395			19,395
Total liabilities	365,566	769,492	(51,265)	1,083,793
SHAREHOLDERS EQUITY				
Total shareholders equity (deficit)	243,949	(25,148)		218,801

Total liabilities and shareholders equity	609,515	744,344	(51,265)	1,302,594
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MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2007

(Unaudited)

(Euros in thousands, except for shares and per share data)

Note 9. Restricted Group Supplemental Disclosure (cont d)

Combined Condensed Statement of Operations

	Six Months Ended June 30, 2007			
	Restricted Group	Unrestricted Subsidiary	Eliminations	Consolidated Group
Revenues	204,240	141,894		346,134
Operating costs	161,829	115,726		277,555
Operating depreciation and amortization	13,661	14,058		27,719
General and administrative expenses	10,623	5,583		16,206
(Sale) purchase of emission allowances	(268)	(498)		(766)
	185,845	134,869		320,714
Operating income from continuing operations	18,395	7,025		25,420
Other income (expense)				
Interest expense	(14,418)	(25,132)	1,841	(37,709)
Investment income	2,440	2,596	(1,841)	3,195
Unrealized foreign exchange gain on debt	2,263	340		2,603
Derivative financial instruments, net		24,672		24,672
Total other (expense) income	(9,715)	2,476		(7,239)
Income before income taxes and minority interest from continuing operations	8,680	9,501		18,181
Income tax provision	(4,150)	(9,555)		(13,705)
Income (loss) before minority interest from continuing operations	4,530	(54)		4,476
Minority interest		(43)		(43)
Net income (loss) from continuing operations	4,530	(97)		4,433
Net loss from discontinued operations	(188)			(188)
Net income (loss)	4,342	(97)		4,245

	Six Months Ended June 30, 2006			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues	169,752	122,510		292,262

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Operating costs	148,388	90,904		239,292
Operating depreciation and amortization	14,197	14,128		28,325
General and administrative expenses	10,375	5,939		16,314
(Sale) purchase of emission allowances	(3,651)	(9,595)		(13,246)
	169,309	101,376		270,685
Operating income from continuing operations	443	21,134		21,577
Other income (expense)				
Interest expense	(16,442)	(31,046)	1,760	(45,728)
Investment income	2,119	2,644	(1,760)	3,003
Unrealized foreign exchange gain on debt	12,173			12,173
Derivative financial instruments, net		85,505		85,505