

MERCER INTERNATIONAL INC.

Form 10-Q

November 04, 2008

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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 September 30, 2008

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)*

47-0956945
*(I.R.S. Employer
Identification No.)*

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)

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, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a 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 36,422,487 shares of common stock outstanding as at November 3, 2008.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**MERCER INTERNATIONAL INC.
INTERIM CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008
(Unaudited)**

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

	September 30, 2008	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	75,779	84,848
Receivables	81,503	89,890
Note receivable, current portion	628	5,896
Inventories (Note 4)	129,965	103,610
Prepaid expenses and other	10,126	6,015
Total current assets	298,001	290,259
Long-term assets		
Cash, restricted (Note 8)	13,000	33,000
Property, plant and equipment	904,653	933,258
Investments (Note 8)	646	96
Deferred note issuance and other costs	4,326	5,303
Deferred income tax	25,432	17,624
Note receivable, less current portion	3,650	3,977
	951,707	993,258
Total assets	1,249,708	1,283,517
LIABILITIES		
Current liabilities		
Accounts payable and accrued expenses	87,315	87,000
Pension and other post-retirement benefit obligations, current portion	955	493
Debt, current portion	36,599	34,023
Total current liabilities	124,869	121,516
Long-term liabilities		
Debt, less current portion	795,445	815,832
Unrealized interest rate derivative losses (Note 8)	17,370	21,885
Pension and other post-retirement benefit obligations (Note 6)	18,361	19,983
Capital leases and other	12,290	8,999
Deferred income tax	29,277	18,640
	872,743	885,339
Total liabilities	997,612	1,006,855

SHAREHOLDERS EQUITY

Share capital (Note 7)	203,438	202,844
Additional paid-in capital	461	134
Retained earnings	23,986	37,419
Accumulated other comprehensive income	24,211	36,265
Total shareholders equity	252,096	276,662
Total liabilities and shareholders equity	1,249,708	1,283,517

Commitments and Contingencies (Note 9)

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		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Revenues	178,603	191,111	528,289	537,245
Costs and expenses				
Operating costs	144,762	148,529	427,105	426,831
Operating depreciation and amortization	14,033	14,284	41,668	42,003
	19,808	28,298	59,516	68,411
Selling, general and administrative expenses	9,954	6,841	24,803	22,300
(Sale) purchase of emission allowances				(766)
Operating income from continuing operations	9,854	21,457	34,713	46,877
Other income (expense)				
Interest expense	(16,424)	(17,299)	(49,057)	(54,108)
Investment income (loss)	(2,031)	1,491	(300)	3,786
Foreign exchange gain (loss) on debt	(9,560)	4,626	(3,291)	7,229
Realized gain on derivative instruments (Note 5)				6,820
Unrealized gain (loss) on derivative instruments (Note 5)	(8,215)	(5,696)	4,515	12,156
Total other income (expense)	(36,230)	(16,878)	(48,133)	(24,117)
Income (loss) before income taxes and minority interest from continuing operations	(26,376)	4,579	(13,420)	22,760
Income tax benefit (provision) current	(231)	(144)	(68)	(877)
deferred	6,144	7,013	(2,982)	(5,959)
Income (loss) before minority interest from continuing operations	(20,463)	11,448	(16,470)	15,924
Minority interest	3,290	(742)	3,037	(785)
Net income (loss) from continuing operations	(17,173)	10,706	(13,433)	15,139
Net income (loss) from discontinued operations		(10)		(198)
Net income (loss)	(17,173)	10,696	(13,433)	14,941
Retained earnings, beginning of period	41,159	19,485	37,419	15,240
Retained earnings, end of period	23,986	30,181	23,986	30,181

Net income (loss) from continuing operations per share				
(Note 3):				
Basic	(0.47)	0.30	(0.37)	0.42
Diluted	(0.47)	0.26	(0.37)	0.40
Net income (loss) per share:				
Basic	(0.47)	0.29	(0.37)	0.41
Diluted	(0.47)	0.26	(0.37)	0.39

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

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MERCER INTERNATIONAL INC.
INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(In thousands of Euros)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Net income (loss)	(17,173)	10,696	(13,433)	14,941
Other comprehensive income (loss):				
Foreign currency translation adjustment	(3,992)	11,665	(12,040)	29,919
Unrealized (losses) gains on securities arising during the period	8	(16)	(14)	71
Other comprehensive (loss) income	(3,984)	11,649	(12,054)	29,990
Total comprehensive (loss) income	(21,157)	22,345	(25,487)	44,931

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		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Cash flows from (used in) operating activities:				
Net income (loss)	(17,173)	10,696	(13,433)	14,941
Adjustments to reconcile net income to cash flows from operating activities				
Unrealized (gain) loss on derivatives	8,215	5,696	(4,515)	(12,156)
Foreign exchange (gain) loss on debt	9,560	(4,626)	3,291	(7,229)
Loss (gain) on sale of assets	177	151	(781)	128
Operating depreciation and amortization	14,033	14,284	41,668	42,003
Non-operating amortization	70	67	211	194
Minority interest	(3,290)	742	(3,037)	785
Deferred income taxes	(6,144)	(7,013)	2,982	5,959
Stock compensation expense	213	154	568	350
Pension and other post-retirement expense	497	411	1,502	1,366
Pension and other post-retirement benefit funding	(402)	(367)	(1,527)	(1,201)
Other	108	(37)	(377)	912
Changes in current assets and liabilities				
Receivables	18,352	7,407	7,674	(19,314)
Inventories	(19,753)	(1,479)	(27,436)	(31,149)
Accounts payable and accrued expenses	(3,806)	(9,519)	1,995	5,610
Other	(3,546)	659	(2,245)	1,939
Net cash from (used in) operating activities	(2,889)	17,226	6,540	3,138
Cash flows from (used in) investing activities:				
Purchase of property, plant and equipment ⁽¹⁾	(9,269)	7,833	(17,130)	(2,704)
Proceeds on sale of property, plant and equipment	271	11	1,884	538
Cash, restricted	20,000	12,000	20,000	24,000
Notes receivable		(11)	5,303	4,720
Net cash from (used in) investing activities	11,002	19,833	10,057	26,554
Cash flows from (used in) financing activities:				
Repayment of notes payable and debt	(17,132)	(13,412)	(34,023)	(26,865)
Repayment of capital lease obligations	300	(1,646)	(532)	(4,222)
Proceeds from borrowings of notes payable and debt			8,431	
Issuance of common shares				305
Net cash from (used in) financing activities	(16,832)	(15,058)	(26,124)	(30,782)

Effect of exchange rate changes on cash and cash equivalents	1,203	(407)	458	1,764
Net increase (decrease) in cash and cash equivalents	(7,516)	21,594	(9,069)	674
Cash and cash equivalents, beginning of period ⁽²⁾	83,295	48,884	84,848	69,804
Cash and cash equivalents, end of period ⁽³⁾	75,779	70,478	75,779	70,478

(1) 2007 includes amounts received in the third quarter of 2007, and recorded as a reduction of property, plant and equipment (approximately 9,100) upon the settlement of the Stendal engineering, procurement and construction (EPC) contract.

(2) Includes amounts related to discontinued operations of: 2008 nil (2007 437).

(3) Includes amounts related to discontinued operations of: 2008 nil (2007 1,037).

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 (continued)
(Unaudited)
(In thousands of Euros)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Supplemental disclosure of cash flow information:				
Cash paid (received) during the period for:				
Interest	26,209	48,512	56,975	66,136
Income taxes	59	(218)	(259)	397
Supplemental schedule of non-cash investing and financing activities:				
Acquisition of production and other equipment under capital lease obligations	1,085	(127)	4,784	2,088
Common shares issued in satisfaction of floating rate note				6,728

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. 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 the NASDAQ Global Market and the Toronto Stock Exchange, respectively.

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. 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, 2007. 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 operating 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 unaudited interim consolidated financial statements have been reclassified to conform to the current year presentation.

New Accounting Standards

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards 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. FAS 159 is intended to improve 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 Company adopted FAS 159 effective January 1, 2008, the impact of which was not material.

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

(In thousands of Euros, except per share data)

Note 1. Basis of Presentation (continued)

In February 2008, FASB issued FASB Staff Position No. FAS 157-2 (FSP 157-2), *Effective Date of FASB Statement No. 157*, which provides a one year deferral of the effective date of the statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157) for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. In accordance with this interpretation, the Company has only adopted the provisions of FAS 157 with respect to its financial assets and liabilities that are measured at fair value within the financial statements as of December 31, 2007. The provisions of FAS 157 have not been applied to non-financial assets and non-financial liabilities, such as asset retirement obligations.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (FAS 161). FAS 161 requires enhanced disclosures about how and why companies use derivatives, how derivative instruments and related hedged items are accounted for and how derivative instruments and related hedged items affect a company s financial position, financial performance and cash flows. The provisions of FAS 161 are effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. Consequently, FAS 161 will be effective for the Company s quarter ended March 31, 2009. The Company is in the process of determining the impact, if any, the adoption of FAS 161 will have on its financial statement disclosures.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (FAS 162). FAS 162 defines the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. The provisions of FAS 162 are effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendment to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The Company is in the process of determining the impact, if any, the adoption of FAS 162 will have on its financial statements and disclosures.

In May 2008, the FASB issued FASB Staff Position APB 14-1 *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Settlement)* (FSP 14-1). FSP 14-1 states that convertible debt instruments that are within its scope are required to be separated into both a debt component and an equity component. In addition, any debt discount is to be accreted to interest expense over the expected life of the debt. The provisions of FSP 14-1 are effective for financial statements issued for fiscal years beginning after December 15, 2008, and implementation is generally required to be retrospective. Early adoption is not permitted. The Company is in the process of determining the impact, if any, the adoption of FSP 14-1 will have on its financial statements and disclosures.

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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

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. 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. During the first quarter of 2008, the Company implemented a new form of stock-based compensation called performance stock under its existing stock incentive plan.

Stock Options

Following is a summary of the status of options outstanding at September 30, 2008:

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	1.75	\$ 6.29	830,000	\$ 6.29
7.30	30,000	6.75	7.30	30,000	7.30
7.92	68,334	7.00	7.92	68,334	7.92

During the three and nine month periods ended September 30, 2008, no options were exercised, cancelled or expired. During the nine month period ended September 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 and 135,000 options expired during the period. The average intrinsic value of the options exercised was \$4.58 per option.

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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 two years. Expense is recognized on a straight-line basis over the vesting period. Expense recognized for the three and nine months ended September 30, 2008 were 38 and 139, respectively (2007 88 and 231).

As at September 30, 2008, the total remaining unrecognized compensation cost related to restricted stock amounted to approximately 82 (2007 173), which will be amortized over their remaining vesting period.

During the three month period ended September 30, 2008, no restricted stock awards were granted to independent directors and officers of the Company (2007 21,000). During the nine month period ended September 30, 2008, 21,000 restricted stock awards were granted (2007 21,000). There were nil (2007 nil) restricted stock awards cancelled during the three and nine month periods ended September 30, 2008.

As at September 30, 2008, the total number of restricted stock awards outstanding was 232,685.

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. During the nine months ended September 30, 2008, potential stock based performance awards totaled 570,615 shares, which vest on December 31, 2010. Expense recognized for the three and nine month periods ended September 30, 2008, was 175 and 429, respectively (2007 nil and nil).

As at September 30, 2008, the total remaining unrecognized compensation cost associated with the performance stock totaled approximately 1,633 which will be amortized over their remaining vesting period.

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

(In thousands of Euros, except per share data)

Note 3. Income Per Share

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Net income (loss) from continuing operations basic	(17,173)	10,706	(13,433)	15,139
Interest on convertible notes, net of tax		1,050		2,956
Net income (loss) from continuing operations diluted	(17,173)	11,756	(13,433)	18,095
Net income (loss) from continuing operations per share:				
Basic	(0.47)	0.30	(0.37)	0.42
Diluted	(0.47)	0.26	(0.37)	0.40
Net income (loss) from continuing operations	(17,173)	10,706	(13,433)	15,139
Net income (loss) from discontinued operations		(10)		(198)
Net income (loss) basic	(17,173)	10,696	(13,433)	14,941
Interest on convertible notes, net of tax		1,050		2,956
Net income (loss) diluted	(17,173)	11,746	(13,433)	17,897
Net income (loss) per share:				
Basic	(0.47)	0.29	(0.37)	0.41
Diluted	(0.47)	0.26	(0.37)	0.39
Weighted average number of common shares outstanding:				
Basic	36,422,487	36,284,343	36,388,666	36,012,152
Effect of dilutive instruments:				
Stock options and awards	6,066	285,684	70,054	405,326
Convertible notes		8,678,065		8,920,022
Diluted	36,428,553	45,248,092	36,458,720	45,337,500

The calculation of diluted income per share does not include the exercise of instruments that would have an anti-dilutive effect on earnings per share.

Convertible notes excluded from the calculation of diluted income per share for the three and nine month periods ended September 30, 2008 because they are anti-dilutive represented 8,678,065 shares (2007 nil). Performance stock excluded from the calculation of diluted income per share for both the three and nine month periods ended September 30, 2008 because they are anti-dilutive represented 285,297 shares (2007 nil).

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

(In thousands of Euros, except per share data)

Note 4. Inventories

	September 30, 2008	December 31, 2007
Raw materials	46,981	38,045
Finished goods	57,143	43,127
Work in process and other	25,841	22,438
	129,965	103,610

Note 5. Derivatives Transactions

	Three Months Ended September 30,	
	2008	2007
Realized net gain on foreign exchange derivatives		
Unrealized net gain (loss) on interest rate derivatives	(8,215)	(5,696)
Unrealized net gain (loss) on foreign exchange derivatives		
Unrealized net gain (loss) on derivative financial instruments	(8,215)	(5,696)

	Nine Months Ended September 30,	
	2008	2007
Realized net gain (loss) on foreign exchange derivatives		6,820
Unrealized net gain (loss) on interest rate derivatives	4,515	18,089
Unrealized net gain (loss) on foreign exchange derivatives		(5,933)
Unrealized net gain (loss) on derivative financial instruments	4,515	12,156

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

(In thousands of Euros, except 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 mills.

The largest component of this obligation is with respect to the Celgar mill which maintains defined benefit pension and post-retirement benefit 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 three and nine month periods ended September 30, 2008 totaled 402 and 1,527, respectively (2007 367 and 1,201).

The Company anticipates based on actuarial estimates that it will make contributions to the defined benefit pension plan of approximately 1,614 (C\$2.5 million) in 2008.

Effective December 31, 2008, the defined benefit plan will be closed to new members. In addition, the defined benefit service accrual will cease on December 31, 2008, and members will begin to accrue benefits under a new defined contribution plan effective January 1, 2009.

	Three Months Ended September 30,		2008		2007	
	Pension	Post-	Pension	Post-	Pension	Post-
	Benefits	Retirement	Benefits	Retirement	Benefits	Retirement
		Benefits		Benefits		Benefits
Service cost	197	125	215	121	215	121
Interest cost	339	200	349	190	349	190
Expected return on plan assets	(385)		(428)		(428)	
Recognized net loss		21		16		16
Net periodic benefit cost	151	346	136	327	136	327

	Nine Months Ended September 30,		2008		2007	
	Pension	Post-	Pension	Post-	Pension	Post-
	Benefits	Retirement	Benefits	Retirement	Benefits	Retirement
		Benefits		Benefits		Benefits
Service cost	596	379	623	351	623	351
Interest cost	1,025	605	1,014	551	1,014	551
Expected return on plan assets	(1,165)		(1,241)		(1,241)	
Recognized net loss		62		46		46
Net periodic benefit cost	456	1,046	396	948	396	948

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

(In thousands of Euros, except per share data)

Note 7. Share Capital

Authorized

Preferred shares with U.S. \$1 par value issuable in series: 50,000,000 (2007 50,000,000)

Series A: 2,000,000 (2007 2,000,000)

Common shares with U.S. \$1 par value: 200,000,000 (2007 200,000,000)

Issued and Outstanding

Common shares 36,422,487 (2007 36,285,027)

Note 8. Financial Instruments

The Company adopted FAS 157 effective January 1, 2008. The adoption of FAS 157 resulted in no impact on the Company's consolidated financial position or results from operations.

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 FAS 157. The fair value hierarchy per FAS 157 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. The Company also holds highly liquid investments within restricted cash, which are marked to market at the end of each period. 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.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(In thousands of Euros, except per share data)

Note 8. Financial Instruments (continued)

The valuation techniques used by Mercer 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 fair value of the interest rate swaps represents the Company's exposure on the derivative contracts.

The following table presents a summary of the Company's outstanding financial instruments and their estimated fair values under the hierarchy defined in FAS 157:

Fair value measurements at September 30, 2008 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 held in restricted cash (a)	7,974			7,974
Investments (a)	646			646
Total assets	8,620			8,620
Liabilities				
Derivatives (b)				
- Interest rate swaps		17,370		17,370

(a) Based on observable market data.

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

Note 9. Commitments and Contingencies

In April 2008, as part of a new energy project for the Celgar mill, the Company entered into a contract for the purchase of a new 48 megawatt condensing turbine-generator set. The value of the contract is approximately 7,300 (C\$11.0 million). The Company has made subsequent payments totaling approximately 1,700 (C\$2.8 million). In the

third quarter, the Company continued to make progress with the Celgar energy project and as a result has made additional commitments, primarily for equipment totalling approximately 6,200 (C\$9.3 million), of which approximately 66 (C\$0.1 million) was paid during the period.

In July 2008, as part of a bleaching project line renewal at the Rosenthal mill, the Company entered into a contract for the purchase of equipment. The value of the contract is approximately 4,200, and as at September 30, 2008, the Company had made payments totaling 630.

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

(In thousands of Euros, except per share data)

Note 10. Restricted Group Supplemental Disclosure

The terms of the indenture governing our 9.25% 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 and nine months ended September 30, 2008 and 2007, 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 Sheet

	September 30, 2008			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
ASSETS				
Current				
Cash and cash equivalents	61,689	14,090		75,779
Receivables	37,388	44,115		81,503
Note receivable, current portion	628			628
Inventories	80,543	49,422		129,965
Prepaid expenses and other	7,341	2,785		10,126
Total current assets	187,589	110,412		298,001
Cash, restricted		13,000		13,000
Property, plant and equipment	370,672	533,981		904,653
Other	4,967	5		4,972
Deferred income tax	20,321	5,111		25,432
Due from unrestricted group	54,646		(54,646)	
Note receivable, less current portion	3,650			3,650
Total assets	641,845	662,509	(54,646)	1,249,708
LIABILITIES				
Current				
Accounts payable and accrued expenses	49,739	37,576		87,315
Pension and other post-retirement benefit obligations, current portion	955			955
Debt, current portion		36,599		36,599
Total current liabilities	50,694	74,175		124,869
Debt, less current portion	291,372	504,073		795,445
Due to restricted group		54,646	(54,646)	
Unrealized derivative loss		17,370		17,370
Pension and other post-retirement benefit obligations	18,361			18,361
Capital leases and other	7,599	4,691		12,290
Deferred income tax	12,065	17,212		29,277

Total liabilities	380,091	672,167	(54,646)	997,612
SHAREHOLDERS EQUITY				
Total shareholders equity (deficit)	261,754	(9,658)		252,096
Total liabilities and shareholders equity	641,845	662,509	(54,646)	1,249,708

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

(In thousands of Euros, except per share data)

Note 10. Restricted Group Supplemental Disclosure (continued)**Combined Condensed Balance Sheet**

	December 31, 2007			
	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
ASSETS				
Current				
Cash and cash equivalents	59,371	25,477		84,848
Receivables	37,482	52,408		89,890
Note receivable, current portion	589	5,307		5,896
Inventories	63,444	40,166		103,610
Prepaid expenses and other	3,714	2,301		6,015
Total current assets	164,600	125,659		290,259
Cash, restricted		33,000		33,000
Property, plant and equipment	385,569	547,689		933,258
Other	5,399			5,399
Deferred income tax	10,852	6,772		17,624
Due from unrestricted group	57,457		(57,457)	
Note receivable, less current portion	3,977			3,977
Total assets	627,854	713,120	(57,457)	1,283,517
LIABILITIES				
Current				
Accounts payable and accrued expenses	43,621	43,379		87,000
Pension and other post-retirement benefit obligations, current portion	493			493
Debt, current portion		34,023		34,023
Total current liabilities	44,114	77,402		121,516
Debt, less current portion	273,589	542,243		815,832
Due to restricted group		57,457	(57,457)	
Unrealized derivative loss		21,885		21,885
Pension and other post-retirement benefit obligations	19,983			19,983
Capital leases and other	7,033	1,966		8,999
Deferred income tax	4,553	14,087		18,640
Total liabilities	349,272	715,040	(57,457)	1,006,855

SHAREHOLDERS EQUITY

Total shareholders equity (deficit)	278,582	(1,920)		276,662
Total liabilities and shareholders equity	627,854	713,120	(57,457)	1,283,517

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

Note 10. Restricted Group Supplemental Disclosure (continued)**Combined Condensed Statements of Operations**

Three Months Ended September 30, 2008

	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues	102,604	75,999		178,603
Operating costs	88,718	56,044		144,762
Operating depreciation and amortization	7,333	6,700		14,033
Selling, general and administrative expenses	6,585	3,369		9,954
	102,636	66,113		168,749
Operating income (loss) from continuing operations	(32)	9,886		9,854
Other income (expense)				
Interest expense	(8,617)	(10,719)	2,912	(16,424)
Investment income (loss)	3,609	(2,728)	(2,912)	(2,031)
Foreign exchange gain (loss) on debt	(9,560)			(9,560)
Derivative financial instruments		(8,215)		(8,215)
Total other income (expense)	(14,568)	(21,662)		(36,230)
Income (loss) before income taxes and minority interest from continuing operations	(14,600)	(11,776)		(26,376)
Income tax benefit (provision)	5,173	740		5,913
Income (loss) before minority interest from continuing operations	(9,427)	(11,036)		(20,463)
Minority interest		3,290		3,290
Net income (loss)	(9,427)	(7,746)		(17,173)

Three Months Ended September 30, 2007

	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues	106,530	84,581		191,111
Operating costs	84,545	63,984		148,529

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Operating depreciation and amortization	7,419	6,865		14,284
Selling, general and administrative expenses	3,610	3,231		6,841
	95,574	74,080		169,654
Operating income (loss) from continuing operations	10,956	10,501		21,457
Other income (expense)				
Interest expense	(6,996)	(11,240)	937	(17,299)
Investment income (loss)	1,321	1,107	(937)	1,491
Foreign exchange gain (loss) on debt	4,545	81		4,626
Derivative financial instruments, net		(5,696)		(5,696)
Total other income (expense)	(1,130)	(15,748)		(16,878)
Income (loss) before income taxes and minority interest from continuing operations	9,826	(5,247)		4,579
Income tax benefit (provision)	(783)	(7,652)		(6,869)
Income before minority interest from continuing operations	9,043	2,405		11,448
Minority interest		(742)		(742)
Net income (loss) from continuing operations	9,043	1,663		10,706
Net income (loss) from discontinued operations	(10)			(10)
Net income (loss)	9,033	1,663		10,696

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

(In thousands of Euros, except per share data)

Note 10. Restricted Group Supplemental Disclosure (continued)
Combined Condensed Statements of Operations

Nine Months Ended September 30, 2008

	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues	301,400	226,889		528,289
Operating costs	254,312	172,793		427,105
Operating depreciation and amortization	21,528	20,140		41,668
Selling, general and administrative expenses	15,194	9,609		24,803
(Sale) purchase of emission allowances				
	291,034	202,542		493,576
Operating income (loss) from continuing operations	10,366	24,347		34,713
Other income (expense)				
Interest expense	(19,769)	(32,200)	2,912	(49,057)
Investment income (loss)	4,972	(2,360)	(2,912)	(300)
Foreign exchange gain (loss) on debt	(3,181)	(110)		(3,291)
Derivative financial instruments		4,515		4,515
Total other income (expense)	(17,978)	(30,155)		(48,133)
Income (loss) before income taxes and minority interest from continuing operations	(7,612)	(5,808)		(13,420)
Income tax benefit (provision)	1,716	(4,766)		(3,050)
Income (loss) before minority interest from continuing operations	(5,896)	(10,574)		(16,470)
Minority interest		3,037		3,037
Net income (loss)	(5,896)	(7,537)		(13,433)

Nine Months Ended September 30, 2007

	Restricted Group	Unrestricted Subsidiaries	Eliminations	Consolidated Group
Revenues	310,770	226,475		537,245

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Operating costs	248,292	178,539		426,831
Operating depreciation and amortization	21,080	20,923		42,003
Selling, general and administrative expenses	12,315	9,985		22,300
(Sale) purchase of emission allowances	(268)	(498)		(766)
	281,419	208,949		490,368
Operating income (loss) from continuing operations	29,351	17,526		46,877
Other income (expense)				
Interest expense	(21,414)	(35,472)	2,778	(54,108)
Investment income (loss)	3,761	2,803	(2,778)	3,786
Foreign exchange gain (loss) on debt	6,808	421		7,229
Derivative financial instruments, net		18,976		18,976
Total other income (expense)	(10,845)	(13,272)		(24,117)
Income (loss) before income taxes and minority interest from continuing operations	18,506	4,254		22,760
Income tax benefit (provision)	(4,933)	(1,903)		(6,836)
Income (loss) before minority interest from continuing operations	13,573	2,351		15,924
Minority interest		(785)		(785)
Net income (loss) from continuing operations	13,573	1,566		15,139
Net income (loss) from discontinued operations	(198)			(198)
Net income (loss)	13,375	1,566		14,941

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 QUARTERLY REPORT PAGE 20

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

In this document: (i) unless the context otherwise requires, references to we, our, us, the Company or Mercer mean Mercer International Inc. and its subsidiaries; (ii) references to Mercer Inc. mean the Company excluding its subsidiaries; (iii) information is provided as of September 30, 2008, 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; and (vi) ADMTs refers to air-dried metric tonnes.

We operate three NBSK pulp mills through our wholly owned subsidiaries, Rosenthal and Celgar, and our 70.6% owned subsidiary, Stendal, which have a consolidated annual production capacity of approximately 1.4 million ADMTs.

The following discussion and analysis of our results of operations and financial condition for the three and nine months ended September 30, 2008 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, 2007 filed with the SEC.

Results of Operations***Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007***

Selected production, sales and exchange rate data for the three months ended September 30, 2008 and 2007 is as follows:

	Three Months Ended September 30,	
	2008	2007
Pulp Production ('000 ADMTs)	368.4	361.0
Scheduled Production Downtime ('000 ADMTs)	9.0	8.0
Pulp Sales ('000 ADMTs)	363.8	363.5
Revenues (in millions)	178.6	191.1
NBSK pulp list prices in Europe (\$/ADMT)	\$ 878	\$ 810
NBSK pulp list prices in Europe (/ADMT)	585	589
Average pulp sales realizations (/ADMT) ⁽¹⁾	484	520
Average Spot Currency Exchange Rates /(\$)	0.6658	0.7268
C\$ / \$(²)	1.0416	1.0446
C\$ / (³)	1.5620	1.4367

(1) List price less discounts and commissions.

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

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

Revenues for the three months ended September 30, 2008 decreased by 6.5% to 178.6 million from 191.1 million in the comparative quarter of 2007, due to the weaker U.S. dollar in the current quarter which more than offset higher pulp prices.

List prices for NBSK pulp in Europe were approximately 585 (\$878) per ADMT in the third quarter of 2008 compared to approximately 589 (\$810) in the third quarter of 2007, 586 (\$880) in the first quarter of 2008 and 576 (\$900) in the second quarter of 2008. List prices, which had been improving in 2008, started declining towards the latter part of the third quarter as a result of slowing global economies and, in particular, lower demand in China.

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Pulp sales volume remained largely unchanged at 363,775 ADMTs in the current quarter compared to 363,523 ADMTs in the comparative period of 2007.

Average pulp sales realizations decreased by 6.9% to 484 per ADMT in the third quarter of 2008 from 520 per ADMT in the third quarter of 2007 as higher pulp prices were more than offset by the continued weakness in the U.S. dollar during the current quarter.

Partially offsetting the recent declines in pulp prices has been the appreciation of the U.S. dollar versus the Euro and the Canadian dollar which commenced in the latter part of the third quarter and has continued into the fourth quarter. Specifically, since the end of the third quarter to date, the Euro and the Canadian dollar have decreased by approximately 8.1% and 8.5%, respectively, in value against the U.S. dollar. A stronger U.S. dollar is beneficial to us because, although NBSK pulp is primarily quoted in U.S. dollars, our production costs are principally incurred in Euros and Canadian dollars.

Pulp production increased marginally to 368,378 ADMTs in the current quarter from 360,986 ADMTs in the same period of 2007, as all of our mills performed generally well. In the third quarter of 2008, we had a total of 10 days scheduled maintenance downtime at our mills, compared to 9 days in the same period last year.

During the third quarter of 2008, our raw material inventories increased to 47.0 million from 30.8 million at the end of the prior quarter as we built up inventories in anticipation of a slower winter harvesting season. Our pulp inventories increased to 57.1 million in the third quarter of 2008 from 52.2 million at the end of the prior quarter. Pulp inventories at our Celgar mill increased as sales to China slowed considerably in the latter part of the third quarter as a result of the build-up of pulp stocks by Chinese buyers earlier this year. Pulp inventories at our Rosenthal and Stendal mills were generally consistent with the second quarter.

Costs and expenses in the third quarter of 2008 decreased marginally to 168.7 million from 169.7 million in the comparative quarter of 2007.

On average, fiber costs increased by approximately 2.6% in the third quarter of 2008 versus the same period in 2007.

Our fiber costs in Germany decreased slightly in the current quarter from the comparative period of 2007 as the sustained production curtailments by German sawmills and large parts of the European board industry continue and demand for fiber remains generally low. Fiber costs at our Celgar mill increased in the current quarter from the prior quarter and the same period last year as a result of increased whole log chipping and higher freight costs incurred in the delivery of wood chips to the mill. Overall, we currently expect fiber prices in Germany in the fourth quarter and early part of 2009 to remain generally level with third quarter prices. Fiber costs at our Celgar mill are also expected to remain at current levels in the near term and to decrease as we move into 2009 as a result of fiber initiatives implemented at the mill including improvements in transportation logistics and woodroom efficiencies.

We recorded no contribution to income from the sale of emission allowances for the three months ended September 30, 2008 and 2007 as a result of weak markets and prices for the sale of emission allowances. In the third quarter of 2008, sales of surplus energy were approximately 7.2% higher than in the comparative quarter of 2007.

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Operating depreciation and amortization decreased marginally to 14.0 million from 14.3 million in the comparative quarter of 2007.

For the third quarter of 2008, operating income decreased to 9.9 million from 21.5 million in the comparative quarter of 2007, primarily due to lower sales realizations.

Interest expense in the third quarter of 2008 decreased to 16.4 million from 17.3 million in the year ago period, primarily due to lower levels of borrowing.

We recorded an unrealized loss of 8.2 million before minority interests on our interest rate derivatives during the third quarter of 2008. In the comparative quarter of 2007, we recorded an unrealized loss of 5.7 million before minority interests on our then outstanding interest rate derivatives.

In the third quarter of 2008, we recorded an unrealized loss of 9.6 million on our foreign currency denominated debt, compared to an unrealized gain of 4.6 million in the same period of 2007.

In the third quarter of 2008, the minority shareholder's proportionate interest in the Stendal mill's loss for the period was 3.3 million, compared to 0.7 million of income in the third quarter of 2007.

We reported a net loss from continuing operations for the third quarter of 2008 of 17.2 million, or 0.47 per basic and diluted share. In the third quarter of 2007, we reported net income from continuing operations of 10.7 million, or 0.30 per basic share and 0.26 per diluted share.

Operating EBITDA decreased to 24.0 million in the third quarter of 2008 from 35.8 million in the three months ended September 30, 2007.

Operating EBITDA is defined as operating income from continuing operations 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, including financing costs and the effect of derivative instruments. Operating EBITDA is not a measure of financial performance under GAAP, and should not be considered as an alternative to net income or income from operations as a measure of operational performance, nor as an alternative to net cash from operating activities as a measure of liquidity.

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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) minority interests on our Stendal NBSK pulp mill operations; (v) the impact of realized or marked to market changes in our derivative positions, which can be substantial; and (vi) the impact of impairment charges against our investments or assets. Because of these limitations, Operating EBITDA should only be considered as a supplemental operational performance measure and should not be considered as a measure of liquidity or cash available to us to invest in the growth of our business. See the Statement of Cash Flows set out in our interim consolidated financial statements included herein. Because all companies do not calculate Operating EBITDA in the same manner, Operating EBITDA as calculated by us may differ from Operating EBITDA or EBITDA as calculated by other companies. We compensate for these limitations by using Operating EBITDA as a supplemental measure of our operational performance and relying primarily on our GAAP financial statements.

The following table provides a reconciliation of net income from continuing operations to Operating EBITDA for the periods indicated:

	Three Months Ended	
	September 30,	
	2008	2007
	(in thousands)	
Net income (loss) from continuing operations	(17,173)	10,706
Minority interest	(3,290)	742
Income taxes (benefits)	(5,913)	(6,869)
Interest expense	16,424	17,299
Investment (income) loss	2,031	(1,491)
Unrealized foreign exchange loss (gain) on debt	9,560	(4,626)
Derivative financial instruments	8,215	5,696
Operating income from continuing operations	9,854	21,457
Add: Depreciation and amortization	14,103	14,351
Operating EBITDA	23,957	35,808

Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007

Selected production, sales and exchange rate data for the nine months ended September 30, 2008 and 2007 is as follows:

	Nine Months Ended September	
	30,	
	2008	2007
Pulp Production (000 ADMTs)	1,086.1	1,034.6
Scheduled Production Downtime (000 ADMTs)	26.0	46.0
Pulp Sales (000 ADMTs)	1,059.2	1,029.7
Revenues (in millions)	528.3	537.2

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NBSK pulp list prices in Europe (\$/ADMT)	\$	886	\$	783
NBSK pulp list prices in Europe (/ADMT)		582		582
Average pulp sales realizations (/ADMT)		493		517
Average Spot Currency Exchange Rates				
/(\$)		0.6572		0.7435
C\$ / \$(²)		1.0185		1.1048
C\$ / (³)		1.5486		1.4844

- (1) List price less discounts and commissions.
- (2) Average Federal Reserve Bank of New York noon spot rate over the reporting period.
- (3) Average Bank of Canada noon spot rate over the reporting period.

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Revenues for the nine months ended September 30, 2008 decreased to 528.3 million from 537.2 million in the comparative period of 2007, as higher sales volumes and pulp prices were more than offset by the weaker U.S. dollar versus the Euro in the current period.

List prices for NBSK pulp in Europe were approximately 582 (\$886) per ADMT in the first nine months of 2008 compared to approximately 582 (\$783) in the first nine months of 2007.

Pulp sales volume increased to 1,059,212 ADMTs in the first nine months of 2008 from 1,029,674 ADMTs in the first nine months of 2007.

Average pulp sales realizations were 493 per ADMT in the first nine months of 2008 compared to 517 per ADMT in the comparative period of 2007, primarily as a result of the weakness of the U.S. dollar versus the Euro during the period.

Pulp production in the first nine months of 2008 increased to 1,086,078 ADMTs from 1,034,592 ADMTs in the same period of 2007, as all of our mills performed generally well. In the first nine months of 2008, we had a total of 22 days scheduled maintenance downtime at our mills, compared to 33 days in the same period last year.

During the first nine months of 2008, our raw material inventories increased to 47.0 million from 38.0 million at the end of 2007. Our pulp inventories increased to 57.1 million in the third quarter of 2008 from 43.1 million at the end of 2007.

Costs and expenses in the first nine months of 2008 increased to 493.6 million from 490.4 million in the comparative period of 2007.

On average, fiber costs decreased by approximately 1.5% in the first nine months of 2008 versus the same period in 2007. Our fiber costs in Germany were approximately 3.3% lower compared to the same period last year as lower demand for fiber from the European board industry reduced pressure on pricing. At our Celgar mill fiber costs increased almost 12.6% from the third quarter of 2007 as the deterioration of the North American housing and lumber markets sharply reduced sawmilling activity and residual chip supply requiring Celgar to increase its levels of whole log chipping. Celgar's fiber costs were also negatively affected by higher freight costs incurred in the delivery of wood chips to the mill.

We recorded no contribution to income from the sale of emission allowances for the nine months ended September 30, 2008 compared to 0.8 million in the same period last year as a result of weak markets and prices for the sale of emission allowances. In the first nine months of 2008, sales of surplus energy were approximately 9.8% higher than in the same period of 2007.

Operating depreciation and amortization decreased marginally to 41.7 million in the first nine months of 2008 from 42.0 in the same period last year.

For the first nine months of 2008, operating income decreased to 34.7 million from 46.9 million in the comparative period of 2007.

Interest expense in the first nine months of 2008 decreased to 49.1 million from 54.1 million in the year ago period, primarily due to a lower level of borrowing.

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We recorded an unrealized gain of \$4.5 million before minority interests on our interest rate derivatives during the first nine months of 2008. In the comparative period of 2007, we recorded a gain of \$19.0 million before minority interests on our then outstanding derivatives, which included a realized gain of \$6.8 million from the settlement of currency swaps.

In the first nine months of 2008, we recorded a loss of \$3.3 million on our foreign currency denominated debt, compared to a gain of \$7.2 million in the comparative period of 2007.

In the first nine months of 2008, the minority shareholder's proportionate interest in the Stendal mill's loss for the period was \$3.0 million, compared to \$0.8 million of income in the same period of 2007.

We reported a net loss from continuing operations for the first nine months of 2008 of \$13.4 million, or \$0.37 per basic and diluted share. In the first nine months of 2007, we reported net income from continuing operations of \$15.1 million, or \$0.42 per basic share and \$0.40 per diluted share.

Operating EBITDA was \$76.6 million in the first nine months of 2008 from \$89.1 million in the nine months ended September 30, 2007. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our results for the three months ended September 30, 2008 for additional information relating to Operating EBITDA.

The following table provides a reconciliation of net income from continuing operations to Operating EBITDA for the periods indicated:

	Nine Months Ended September 30, 2008 2007 (in thousands)	
Net income (loss) from continuing operations	(13,433)	15,139
Minority interest	(3,037)	785
Income taxes (benefits)	3,050	6,836
Interest expense	49,057	54,108
Investment (income) loss	300	(3,786)
Unrealized foreign exchange (gain) loss on debt	3,291	(7,229)
Derivative financial instruments	(4,515)	(18,976)
Operating income from continuing operations	34,713	46,877
Add: Depreciation and amortization	41,879	42,197
Operating EBITDA	76,592	89,074

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Table of Contents**Liquidity and Capital Resources**

The following table is a summary of selected financial information for the periods indicated:

	As at September 30, 2008	As at December 31, 2007
	(in thousands)	
Financial Position		
Cash and cash equivalents	75,779	84,848
Working capital	173,132	168,743
Property, plant and equipment	904,653	933,258
Total assets	1,249,708	1,283,517
Long-term liabilities	872,743	885,339
Shareholders' equity	252,096	276,662

As at September 30, 2008 and December 31, 2007, our cash and cash equivalents were 75.8 million and 84.8 million, respectively. We also had 13.0 million of restricted cash in a debt service account related to the financing for the Stendal mill at the end of the third quarter of 2008 compared to 33.0 million at December 31, 2007. As at September 30, 2008, we had not drawn any amount under the 40.0 million Rosenthal revolving term credit facility and had drawn approximately C\$35.2 million under the C\$40.0 million Celgar revolving credit facility.

We expect to meet our interest and debt service obligations and the working and maintenance capital requirements for our operations, other than the Stendal mill, from cash flow from operations, cash on hand and the two revolving working capital facilities for the Rosenthal and Celgar mills.

The following summary of certain selected provisions of our credit facilities is not complete and these provisions, including definitions of certain terms, are qualified in their entirety by reference to the credit facilities and applicable amendments on file with the SEC.

The Celgar revolving working facility had an initial three-year term and matures in May 2009. It may be extended by our Celgar mill for successive one-year periods upon request and lender acceptance. The maximum amount available under the Celgar facility is C\$40.0 million, subject to borrowing base limitations equal to 85% of eligible accounts receivable and a percentage of eligible inventory varying between 65% and 85%. The facility is secured by a first fixed charge on the Celgar mill's working capital and is guaranteed by Mercer Inc. No security is granted upon the equipment, buildings or real property of the Celgar mill. Advances under the facility are available in Canadian and U.S. dollars. Rates for advances in Canadian and U.S. dollars are equal to a prime rate charged by a Canadian bank plus a margin of 0.50%. Advances are also available under Canadian dollar acceptances and U.S. currency LIBOR rates plus, in each case, a margin of 2.25%. The credit facility is subject to a number of positive and negative covenants customary for credit agreements of this nature including a covenant that, if the excess amount under the credit facility for the Celgar mill is less than C\$8.0 million, then until it becomes equal to or greater than such amount, the Celgar mill must maintain a fixed charge coverage ratio of not less than 1.1:1.0 for each 12-month period.

The Rosenthal revolving working capital facility is in the aggregate amount of 40.0 million and matures in February 2010. There is no borrowing base requirement in this facility and it is secured by a first fixed charge on the working capital of the Rosenthal mill. No security is granted upon the equipment, buildings or real property of Rosenthal. Advances are available in Euros or U.S. dollars. Interest accrues based upon the form of advance at LIBOR or EURIBOR plus a margin of 1.55% plus certain other costs incurred by lenders. The agreement contains positive and negative covenants customary to facilities of this type. They include that for the Rosenthal mill the ratio of net debt to EBITDA must not exceed 3:1 in any 12-month period, there must be an interest ratio coverage of EBITDA to interest expense equal to or in excess of 1.4:1 for each six-month period and there must be a current ratio where current assets to current liabilities must equal or exceed 1.1:1.

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We currently expect to meet the capital requirements for the Stendal mill, including working capital, interest and principal service expenses through cash on hand, cash flow from operations and our 70% owned Stendal mill's loan facility (the Stendal Facility). The Stendal Facility was designed as a project loan facility for the construction and operation of the Stendal mill. It is non-recourse to Mercer Inc. and our other operating subsidiaries. The Stendal Facility of our Stendal mill is our only credit facility with regularly scheduled principal payments, which are due semi-annually until its maturity in 2017. In 2009, the Stendal Facility provides for semi-annual principal payments of approximately \$17.9 million and \$18.7 million. In addition to operating cash flow, the Stendal mill also has approximately \$13.0 million in its debt service reserve account to assist with scheduled payments. Additionally, under the Stendal Facility, the Stendal mill is permitted, at its option, to implement one six-month deferral of scheduled principal payments. As the Stendal Facility is the only credit facility which currently has scheduled principal payments, Stendal has had initial discussions with its lenders to provide for greater financial flexibility given the current distress and uncertainty facing global world markets.

Our expectations as to our liquidity are based upon current market conditions and, in particular, current and expected future pulp pricing and foreign exchange rates.

Operating Activities

Operating activities in the first nine months of 2008 provided cash of \$6.5 million, compared to \$3.1 million in the comparative period of 2007. A decrease in receivables provided cash of \$7.7 million in the first nine months of 2008, compared to using cash of \$19.3 million in the comparative period of 2007. An increase in inventories used cash of \$27.4 million in the first nine months of 2008, compared to \$31.1 million in the same period of 2007.

Working capital is subject to cyclical operating needs, such as the timing of collections and sales and the payment of payables.

Investing Activities

Investing activities in the first nine months of 2008 provided cash of \$10.1 million in large part due to a drawdown of funds in our debt service reserve account to repay principal and interest under the Stendal Facility. The repayment of notes receivable provided cash of \$5.3 million and the sale of equipment provided cash of \$1.9 million. In the nine months ended September 30, 2007 investing activities provided cash of \$26.6 million primarily due to a drawdown of funds in our debt service reserve account under the Stendal facility.

In the first nine months of 2008, capital expenditures, including expenditures related to the Celgar energy project and woodroom upgrade as well as the renewal of a bleaching line at our Rosenthal mill, used cash of \$17.1 million. In the same period last year, capital expenditures used \$2.7 million which included approximately \$9.1 million received in the third quarter of 2007 in connection with the settlement of the Stendal engineering, procurement and construction contract, which was recorded as a reduction of property, plant and equipment.

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Financing Activities

Financing activities used cash of 26.1 million in the nine months ended September 30, 2008, as we paid 34.0 million in scheduled repayments of indebtedness under the Stendal Facility in the first nine months of 2008. In the comparative period in 2007, financing activities used cash of 30.8 million primarily due to scheduled repayments under the Stendal Facility.

Other than commitments totaling approximately 13.5 million relating to the energy project at our Celgar mill which we entered into in the first nine months of 2008, and contracts totaling approximately 4.2 million to purchase equipment for Rosenthal's bleach plant project, we have no material commitments to acquire assets or operating businesses. We anticipate that there will be acquisitions of businesses or commitments to projects in the future. To achieve our long-term goals of expanding our asset and earnings base through the acquisition of interests in companies and assets in the pulp and paper and related businesses, and organically through high return capital expenditures at our operating facilities, we will require substantial capital resources. The required necessary resources for such long-term goals will be generated from cash flow from operations, cash on hand, the sale of securities and/or assets, and borrowing against our assets.

Contractual Obligations and Commitments

There were no material changes outside the ordinary course to any of our contractual obligations during the first nine months of 2008.

Capital Resources

In addition to our current revolving credit facilities for the Rosenthal and Celgar mills, we may seek to raise future funding in the debt markets if our indenture relating to our 9.25% senior notes permits, subject to compliance with the indenture. The indenture governing the senior notes provides that, in order for Mercer Inc. and its restricted subsidiaries (as defined in the indenture and which excludes the Stendal mill) to enter into certain types of transactions, including the incurrence of additional indebtedness, the making of restricted payments and the completion of mergers and consolidations (other than, in each case, those specifically permitted by our senior note indenture), we must meet a minimum ratio of Indenture EBITDA to Fixed Charges as defined in the senior note indenture of 2.0 to 1.0 on a pro forma basis for the most recently ended four full fiscal quarters.

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.

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In the nine months ended September 30, 2008, accumulated other comprehensive income decreased by 12.1 million which was primarily due to the foreign exchange translation.

Based upon the exchange rate at September 30, 2008, the U.S. dollar has increased by approximately 1.0% in value against the Euro since September 30, 2007. See Quantitative and Qualitative Disclosures about Market Risk .

Results of Operations of the Restricted Group Under Our Senior Note Indenture

The indenture governing our 9.25% 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., certain holding subsidiaries, and our Rosenthal and Celgar mills. 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 10 of our quarterly interim consolidated financial statements included herein.

Restricted Group Results Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007

Revenues for the Restricted Group for the three months ended September 30, 2008 decreased to 102.6 million from 106.5 million in the comparative period of 2007, primarily due to the weaker U.S. dollar relative to the Euro which more than offset higher pulp prices.

List prices for NBSK pulp in Europe were approximately 585 (\$878) per ADMT in the third quarter of 2008 and approximately 589 (\$810) in the same period of 2007.

Pulp sales volume increased to 209,288 ADMTs in the third quarter of 2008 from 201,236 ADMTs in the comparative period of 2007.

Average pulp sales realizations for the Restricted Group were 489 per ADMT in the three months ended September 30, 2008, compared to 528 per ADMT in the comparative period of 2007, as higher pulp prices were more than offset by the weakness in the U.S. dollar during the period.

Pulp production for the Restricted Group increased to 205,628 ADMTs in the third quarter of 2008 from 202,301 ADMTs in the same period of 2007 as our Celgar and Rosenthal mills performed generally well. In the third quarter of 2008, we had a total of 10 days scheduled maintenance downtime at our Rosenthal mill, compared to 9 days in the same period last year.

Pulp inventories for the Restricted Group were higher at September 30, 2008, compared to the same time last year primarily as a result of higher inventories at our Celgar mill which resulted from slowing sales to China in the latter part of the third quarter as a result of the build up of pulp stocks by Chinese buyers earlier this year.

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Cost of sales and general, administrative and other expenses for the Restricted Group in the third quarter of 2008 increased to 102.6 million from 95.6 million in the comparative period of 2007.

Overall, fiber costs of the Restricted Group increased by approximately 8.4% in the third quarter of 2008 versus the same period of 2007. Fiber costs for our Rosenthal mill increased slightly in the third quarter of 2008 from the comparative period of 2007 due to higher prices for sawmill residuals which comprise a significant portion of fiber for the Rosenthal mill. At our Celgar mill fiber costs increased in the third quarter of 2008 as a result of increased whole log chipping and higher freight costs incurred in the delivery of wood chips to the mill.

The Restricted Group recorded no contribution to income from the sale of emission allowances by our Rosenthal mill for the three months ended September 30, 2008 and 2007 as a result of weak markets and prices for the sale of emission allowances. In the current period, sales of surplus energy were approximately 3.4% higher than in the same quarter of 2007.

Operating depreciation and amortization for the Restricted Group remained largely the same at 7.4 million in the third quarter of 2008 and the same period last year.

In the third quarter of 2008, the Restricted Group reported an operating loss of 0.1 million compared to operating income of 11.0 million in the third quarter of 2007, primarily due to lower sales realizations.

Interest expense for the Restricted Group in the third quarter of 2008 increased to 8.6 million from 7.0 million in the same quarter last year due to higher levels of borrowing.

In the third quarter of 2008, the Restricted Group recorded a loss on foreign currency denominated debt of 9.6 million, compared to a gain of 4.5 million in the comparative quarter of 2007.

The Restricted Group reported a net loss from continuing operations for the third quarter of 2008 of 9.4 million. In the third quarter of 2007, the Restricted Group had net income from continuing operations of 9.0 million.

Operating EBITDA for the Restricted Group was 7.4 million in the third quarter of 2008 compared to 18.4 million in the comparative quarter of 2007.

Operating EBITDA is defined as operating income (loss) from continuing operations plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our results for the three months ended September 30, 2008 for additional information relating to such limitations and Operating EBITDA.

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The following table provides a reconciliation of net income from continuing operations to Operating EBITDA for the Restricted Group for the periods indicated:

	Three Months Ended September 30, 2008 2007 (in thousands)	
Restricted Group		
Net income (loss) from continuing operations ⁽¹⁾	(9,427)	9,043
Income taxes	(5,173)	783
Interest expense	8,617	6,996
Investment (income) loss	(3,609)	(1,321)
Unrealized foreign exchange (gain) loss on debt	9,560	(4,545)
Operating income (loss) from continuing operations	(32)	10,956
Add: Depreciation and amortization	7,403	7,486
Operating EBITDA ⁽¹⁾	7,371	18,442

(1) See Note 10 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results.

Restricted Group Results Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007

Revenues for the Restricted Group for the nine months ended September 30, 2008 decreased to 301.4 million from 310.8 million in the comparative period of 2007, primarily as a result of the weak U.S. dollar versus the Euro.

List prices for NBSK pulp in Europe were approximately 582 (\$886) per ADMT in the first nine months of 2008 and approximately 582 (\$783) in the comparative period of 2007.

Pulp sales volume increased to 609,564 ADMTs in the first nine months of 2008 from 589,463 ADMTs in the comparative period of 2007.

Average pulp sales realizations for the Restricted Group were 493 per ADMT in the nine months ended September 30, 2008, compared to 526 per ADMT in the comparative period of 2007, primarily as a result of the weakness of the U.S. dollar versus the Euro during the period.

Pulp production for the Restricted Group increased to 610,338 ADMTs in the first nine months of 2008 from 593,060 ADMTs in the same period of 2007 as our Celgar and Rosenthal mills generally performed well. We had a total of 22 days scheduled maintenance downtime at our Celgar and Rosenthal mills in the nine months ended September 30, 2008 compared to 21 days in the same period last year.

Pulp inventories for the Restricted Group were higher in the first nine months of 2008, compared to the same period last year.

Cost of sales and general, administrative and other expenses for the Restricted Group in the first nine months of 2008 increased to 291.0 million from 281.4 million in the comparative period of 2007.

On average, fiber costs of the Restricted Group increased by approximately 0.6% in the first nine months of 2008 versus the same period of 2007. Fiber costs for our Rosenthal mill declined in the first nine months of 2008 from the comparative period of 2007 as lower demand for fiber from the European board industry reduced pressure on pricing in Germany.

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At our Celgar mill fiber costs were higher in the first nine months of 2008 compared to the same period of 2007 as the deterioration of the North American housing and lumber markets sharply reduced sawmilling activity and residual chip supply requiring Celgar to increase its levels of whole log chipping. Celgar's fiber costs were also negatively affected by higher freight costs incurred in the delivery of wood chips to the mill.

The Restricted Group recorded no contribution to income from the sale of emission allowances by our Rosenthal mill for the nine months ended September 30, 2008 compared to \$0.3 million in the same period last year as a result of weak markets and prices for the sale of emission allowances. In the current period, sales of surplus energy were approximately 4.4% higher than in the same period of 2007.

Operating depreciation and amortization for the Restricted Group increased marginally to \$21.5 million in the current period from \$21.1 million in the comparative period of 2007.

In the first nine months of 2008, the Restricted Group's operating income decreased to \$10.4 million from \$29.4 million in the first nine months of 2007.

Interest expense for the Restricted Group in the first nine months of 2008 decreased to \$19.8 million from \$21.4 million in the same period last year, primarily as a result of lower levels of borrowing.

In the first nine months of 2008, the Restricted Group recorded a loss of \$3.2 million on our foreign currency denominated debt, compared to a gain of \$6.8 million in the comparative period of 2007.

The Restricted Group reported a net loss from continuing operations for the first nine months of 2008 of \$5.9 million.

In the first nine months of 2007, net income from continuing operations for the Restricted Group was \$13.6 million.

Operating EBITDA for the Restricted Group was \$32.1 million in the first nine months of 2008 compared to \$50.6 million in the comparative period of 2007.

Operating EBITDA is defined as operating income (loss) from continuing operations plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our results for the three months ended September 30, 2008 for additional information relating to such limitations and Operating EBITDA.

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The following table provides a reconciliation of net income from continuing operations to Operating EBITDA for the Restricted Group for the periods indicated:

	Nine Months Ended September 30, 2008 2007 (in thousands)	
Restricted Group		
Net income (loss) from continuing operations ⁽¹⁾	(5,896)	13,573
Income taxes (benefits)	(1,716)	4,933
Interest expense	19,769	21,414
Investment (income) loss	(4,972)	(3,761)
Unrealized foreign exchange (gain) loss on debt	3,181	(6,808)
Operating income (loss) from continuing operations	10,366	29,351
Add: Depreciation and amortization	21,739	21,274
Operating EBITDA ⁽¹⁾	32,105	50,625

(1) See Note 10 of the interim consolidated financial statements included elsewhere herein for a reconciliation to our consolidated results.

Liquidity and Capital Resources of the Restricted Group

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

	As at September 30, 2008	As at December 31, 2007
	(in thousands)	
Restricted Group Financial Position⁽¹⁾		
Cash and cash equivalents	61,689	59,371
Working capital	136,895	120,486
Property, plant and equipment	370,672	385,569
Total assets	641,845	627,854
Long-term liabilities	329,397	305,158
Shareholders' equity	261,754	278,582

(1) See Note 10 of the interim

consolidated
financial
statements
included
elsewhere
herein for a
reconciliation to
our consolidated
results.

At September 30, 2008, the Restricted Group had cash and cash equivalents of \$61.7 million, compared to \$59.4 million at December 31, 2007. At September 30, 2008, the Restricted Group had working capital of \$136.9 million.

As at September 30, 2008, we had not drawn any amount under the Rosenthal revolving term credit facility and had drawn approximately C\$35.2 million under the C\$40.0 million Celgar revolving credit facility.

We expect the Restricted Group to meet its interest and debt service obligations and meet the working and maintenance capital requirements for its operations with cash flow from operations, cash on hand and the revolving working capital loan facilities for the Rosenthal and Celgar mills.

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Critical Accounting Policies

The 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. Estimates are used for, but not limited to, the accounting for doubtful accounts, depreciation and amortization, asset impairments, derivative financial instruments, environmental conservation, asset retirement obligations, pensions and post-retirement benefit obligations, income taxes, and contingencies. Actual results could differ from these estimates. 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. 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, 2007.

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. These statements appear in a number of different places in this report and can be identified by words such as estimates, projects, expects, intends, believes, plans, or their negatives or other comparable words. Also look for discussions of strategies that involve risks and uncertainties. Forward-looking statements include statements regarding the outlook for our future operations, forecasts of future costs and expenditures, the evaluation of market conditions, the outcome of legal proceedings, the adequacy of reserves, or other business plans. You are cautioned that any such forward-looking statements are not guarantees and may involve risks and uncertainties. Our actual results may differ materially from those in the forward-looking statements due to risks facing us or due to actual facts differing from the assumptions underlying our estimates. Some of these risks and assumptions include 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, 2007. 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 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 earnings. The length and magnitude of industry cycles have varied over time but generally reflect changes in macro economic conditions and levels of industry capacity.

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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. Although pulp prices have improved commencing in the latter part of 2005 and through the first half of 2008, they fell in the third quarter of 2008. We cannot predict the impact of continued economic weakness in world markets or the impact of war, terrorist activity or other events on our markets.

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 price for 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 manufacturing facilities. 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 raw materials increase, or both, demand for our products may decline and our sales and profitability 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. 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 U.S. dollar and the Euro and to a lesser extent the Canadian dollar, which 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 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 fully 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 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 valuations provided by our counterparties.

During the first nine months of 2008, we recorded an unrealized gain of \$4.5 million before minority interests on our outstanding interest rate derivatives compared to a realized and unrealized gain of \$19.0 million in the comparative period of 2007.

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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. Based on such evaluation, our Principal Executive Officer and Principal Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that are filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to management, including its Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. 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 significant 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, 2007. We do not believe that the outcome of such litigation will have a material adverse effect on our business or financial condition.

ITEM 1A. RISK FACTORS

Other than inherent risks associated with the matters listed below, 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, 2007.

The Celgar green energy project is subject to risks inherent in large capital projects

The new energy project we have commenced at our Celgar mill to increase its production of green energy and optimize its power generation capacity is subject to customary risks and uncertainties inherent in large capital projects which could result in the energy project not completing on schedule or as budgeted. Delays to Celgar receiving any operating permits or any required amendments to such permits could result in construction delays, operational deficiencies or funding shortfalls. Furthermore, the Celgar mill could experience operating difficulties or delays during the start-up period when production of green energy is being ramped up. The Celgar mill may not achieve our planned power generation or cost projections.

The German Renewable Energy Resources Act is subject to governmental amendment

There can be no assurance that the amendments to Germany's Renewable Energy Resources Act scheduled to take effect January 1, 2009 will be implemented in their current form. Additional and future amendments to the Act could adversely affect the eligibility of our Rosenthal and Stendal mills to participate in this statutory program and/or the tariffs paid thereunder. As a result we cannot predict with any certainty the amount of future sales of surplus energy we may be able to generate.

Our business is subject to a number of global economic risks

As widely reported, financial markets in the United States, Europe and Asia have been experiencing extreme disruption in recent months, including, among other things, extreme volatility in security prices, severely diminished liquidity and credit availability, rating downgrades of certain investments and declining valuations of others. Governments have taken unprecedented actions intended to address extreme market conditions that include severely restricted credit and declines in values of real estate and other asset classes.

The extreme disruption in financial markets can adversely affect our business in several ways. Principally, as pulp demand has historically been determined by the level of economic growth and business activity, financial market disruptions are expected to lead to slowdowns in world economies which generally result in lower demand and prices for our product. Additionally, restricted credit availability restrains our customers' ability or willingness to purchase our products resulting in lower revenues. Restricted credit availability also can limit us in the way

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we operate our business, our level of inventories and the amount of capital expenditures we may undertake. Any of these changes can adversely affect our operations and our financial performance.

We are unable to predict the likely duration and severity of the current disruption in financial markets and adverse economic conditions on world economies and pulp markets.

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: November 4, 2008
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