MERCER INTERNATIONAL INC.
Form 10-K
February 25, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2007

OR

o **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.: 1333274

MERCER INTERNATIONAL INC.
Exact name of Registrant as specified in its charter

Washington	**47-0956945**
State or other jurisdiction of incorporation or organization	*IRS Employer Identification No.*

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

Registrant s telephone number including area code: (**604) 684-1099**
Securities registered pursuant to Section 12(b) of the Act: **None**
Securities registered pursuant to Section 12(g) of the Act:

Common Stock
Title of Class

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes þ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Act. o Yes þ No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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 o	Accelerated filer þ	Non-accelerated filer o	Smaller reporting company o

(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 Act). o Yes þ No

The aggregate market value of the Registrant s voting and non-voting common equity held by non-affiliates of the Registrant as of June 30, 2007, the last business day of the Registrant s most recently completed second fiscal quarter, based on the closing price of the voting stock on the NASDAQ Global Market on such date, was approximately $36,893,075.

As of February 21, 2008, the Registrant had 36,285,027 shares of common stock, $1.00 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information that will be contained in the definitive proxy statement for the Registrant s annual meeting to be held in 2008 is incorporated by reference into Part III of this Form 10-K.

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List of subsidiaries of Registrant
Consent of PricewaterhouseCoopers LLP.
Consent of Deloitte & Touche LLP.
Section 302 C.E.O. Certification
Section 302 C.F.O. Certification
Section 906 C.E.O. Certification
Section 302 C.F.O. Certification

EXCHANGE RATES

Our reporting currency and financial statements included in this report are in Euros, as a significant majority of our business transactions are originally denominated in Euros. We translate non-Euro denominated assets and liabilities at the rate of exchange on the balance sheet date. Revenues and expenses are translated at the average rate of exchange prevailing during the period.

The following table sets out exchange rates, based on the noon buying rates in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) for the conversion of Euros and Canadian dollars to U.S. dollars in effect at the end of the following periods, the average exchange rates during these periods (based on daily Noon Buying Rates) and the range of high and low exchange rates for these periods:

	Years Ended December 31,				
	2007	**2006**	**2005**	**2004**	**2003**
			(/$)		
End of period	0.6848	0.7577	0.8445	0.7942	0.7938
High for period	0.7750	0.8432	0.8571	0.8473	0.9652
Low for period	0.6729	0.7504	0.7421	0.7339	0.7938
Average for period	0.7294	0.7962	0.8033	0.8040	0.8838
			(C$/$)		
End of period	0.9881	1.1653	1.1659	1.2034	1.2923
High for period	0.9168	1.0989	1.1507	1.1775	1.2923
Low for period	1.1852	1.1726	1.2704	1.3970	1.5751
Average for period	1.0740	1.1344	1.2116	1.3017	1.3916

On February 21, 2008, the Noon Buying Rate for the conversion of Euros and Canadian dollars to U.S. dollars was 0.6751 per U.S. dollar and C$1.0083 per U.S. dollar.

In addition, certain financial information relating to our Celgar pulp mill, which we acquired in February 2005, included in this annual report is stated in Canadian dollars while we report our financial results in Euros. The following table sets out exchange rates, based on the noon rates as provided by the Bank of Canada, for the conversion of Canadian dollars to Euros in effect at the end of the following periods, the average exchange rates during these periods (based on daily noon rates) and the range of high and low exchange rates for these periods:

	Years Ended December 31,				
	2007	**2006**	**2005**	**2004**	**2003**
			(C$/)		
End of period	1.4428	1.5377	1.3805	1.6292	1.6280
High for period	1.3448	1.3523	1.3576	1.5431	1.4967
Low for period	1.5628	1.5377	1.6400	1.6915	1.6643
Average for period	1.4690	1.4244	1.5095	1.6169	1.5826

On February 21, 2008, the noon rate for the conversion of Canadian dollars to Euros was C$1.4940 per Euro.

PART I

ITEM 1. BUSINESS

In this document, please note the following:

references to we , our , us , the Company or Mercer mean Mercer International Inc. and its subsidiaries, u the context clearly suggests otherwise, and references to Mercer Inc. mean Mercer International Inc. excluding its subsidiaries;

references to ADMTs mean air-dried metric tonnes;

information is provided as of December 31, 2007, unless otherwise stated or the context clearly suggests otherwise;

all references to monetary amounts are to Euros , the lawful currency adopted by most members of the European Union, unless otherwise stated; and

refers to Euros; $ refers to U.S. dollars; and C$ refers to Canadian dollars.

The Company

General

Mercer Inc. is a Washington corporation and our shares of common stock are quoted and listed for trading on the NASDAQ Global Market (MERC) and the Toronto Stock Exchange (MRI.U). We converted our corporate form from a Washington business trust to a corporation effective March 1, 2006 without effecting any change in our business, management, accounting practices, assets or liabilities.

We operate in the pulp business and are the second largest producer of market northern bleached softwood kraft, or NBSK , pulp in the world. We are the sole kraft pulp producer, and the only producer of pulp for resale, known as market pulp , in Germany, which is the largest pulp import market in Europe. We also have significant sales to Asia, including China, which is the region with the fastest rate of growth in demand. Our operations are currently located in eastern Germany and western Canada. We currently employ approximately 1,076 people at our German operations, 396 people at our Celgar mill in western Canada and 18 people at our office in Vancouver, British Columbia, Canada. We operate three NBSK pulp mills with a consolidated annual production capacity of approximately 1.4 million ADMTs:

Rosenthal mill. Our wholly-owned subsidiary, Rosenthal, owns and operates a modern, efficient ISO 9002 certified NBSK pulp mill that has a current annual production capacity of approximately 325,000 ADMTs. The Rosenthal mill is located near the town of Blankenstein, Germany.

Stendal mill. Our 70.6% owned subsidiary, Stendal, completed construction of a new, state-of-the-art, single-line NBSK pulp mill in September 2004, which had an initial annual production capacity of approximately 552,000 ADMTs. The addition of two new digesters in December 2005, along with other measures, increased its current annual production capacity to approximately 620,000 ADMTs. The Stendal mill is situated near the town of Stendal, Germany, approximately 300 kilometers north of the Rosenthal

mill.

Celgar mill. Our wholly owned subsidiary, Celgar, owns and operates the Celgar mill, a modern, efficient ISO 9001 certified NBSK pulp mill that had an annual production capacity of approximately 430,000 ADMTs when it was acquired in February 2005. A capital project completed in 2007 and other measures have increased the mill s current annual production capacity to approximately 480,000 ADMTs. The Celgar mill is located near the city of Castlegar, British Columbia, Canada, approximately 600 kilometers east of the port city of Vancouver, British Columbia, Canada.

We have a global sales and marketing team that handles sales to over 140 customers. As a result of the close proximity of our mills to customers and our global platform, we can service our customers on a worldwide basis.

History and Development of Business

We originally invested in various real estate assets with the intention of becoming a real estate investment trust, but in 1985 changed our operational direction to acquiring controlling interests in operating companies. We acquired our initial pulp and paper operations in 1993.

In late 1999, we completed a major capital project which, among other things, converted the Rosenthal mill to the production of kraft pulp from sulphite pulp, increased its annual production capacity from approximately 160,000 ADMTs to approximately 280,000 ADMTs, reduced costs and improved efficiencies. The aggregate cost of this conversion project was approximately 361.0 million, of which approximately 102.0 million was financed through government grants. Subsequent minor capital investments and efficiency improvements have reduced emissions and energy costs and increased the Rosenthal mill s annual production capacity to approximately 325,000 ADMTs.

In September 2004, we completed construction of the Stendal mill at an aggregate cost of approximately 1.0 billion. The Stendal mill is one of the largest NBSK pulp mills in Europe. The Stendal mill was financed through a combination of government grants totaling approximately 275 million, low-cost, long-term project debt which is largely severally guaranteed by the federal government and a state government in Germany, and equity contributions. We initially had a 63.6% ownership interest in Stendal and, in October 2006, increased our interest to 70.6% by acquiring a 7% minority interest therein for 8.1 million. We may in the future seek to acquire all of the remaining 29.4% minority interest in the Stendal mill.

The Stendal mill was constructed under a 716.0 million fixed-price turn-key engineering, procurement and construction, or EPC , contract between Stendal and the EPC contractor. Under the contract, the EPC contractor was responsible for all planning, design, engineering, procurement, construction and testing in connection with the build-out and start-up of the mill. Pursuant to the EPC contract, construction of the Stendal mill was completed substantially on its planned schedule and budget in September 2004. Such completion meant that the construction and installation of all equipment and works were essentially finished and final checks occurred so that continuous production from the mill could commence. The mill then underwent extensive testing and evaluation to determine whether certain performance requirements had been met. Although the tests were generally successful, the EPC contractor agreed in the first quarter of 2005 to implement certain remedial measures at the mill, including the installation of two additional digesters and related equipment, improvements to the non-condensable gas, or NCG , boiler and water treatment plant. These digesters enhanced the reliability and overall operating performance of the Stendal mill and, along with other measures, increased its annual production capacity to approximately 620,000 ADMTs. The two additional digesters had a capital cost of approximately 8.0 million, of which we paid 2.0 million and the balance was paid by the EPC contractor and certain suppliers.

Subsequently, each department of the mill was tested on a stand-alone basis for compliance with its design specifications. Based upon such testing, Stendal made a number of warranty claims. In September 2007, Stendal concluded a final settlement of substantially all outstanding matters with its contractors under the EPC contract while still maintaining existing warranties. Pursuant to the settlement, Stendal received a payment of approximately 11.0 million.

We, Stendal and its minority shareholder are parties to a shareholders agreement dated August 26, 2002, as amended, to govern our respective interests in Stendal. The agreement contains terms and conditions customary for these types of agreements, including restrictions on transfers of share capital and shareholder loans other than to affiliates, rights of first refusal on share and shareholder loan transfers, pre-emptive rights and piggyback rights on dispositions of our interest. The shareholders are not obligated to fund any further equity capital contributions to the project. The shareholders agreement provides that Stendal s managing directors may be appointed by holders of a simple majority of its share capital. Further, shareholder decisions, other than those mandated by law or for the provision of financial

assistance to a shareholder, are determined by a simple majority of Stendal s share capital.

A significant portion of the capital investments at our German pulp mills, including the construction of the Stendal mill, were financed through government grants. Since 1999, our German pulp mills have benefited from an aggregate 383.0 million in government grants. These grants are not reported in our income. These grants reduce the cost basis of the assets purchased when the grants are received. See Capital Expenditures .

In February 2005, we acquired the Celgar mill for $210.0 million, of which $170.0 million was paid in cash and $40.0 million was paid in our shares, plus $16.0 million for the defined working capital at the mill on closing. The Celgar mill was completely rebuilt in the early 1990s through a C$850.0 million modernization and expansion project, which transformed it into a low-cost producer.

In 2007, we completed a C$28.0 million capital project commenced in 2005 which improved efficiencies and reliability and, with other measures, increased the Celgar mill s annual production capacity to 480,000 ADMTs.

We previously operated two paper mills in Germany that had an aggregate annual production capacity of approximately 70,000 ADMTs. We viewed these as non-core operations and divested them in 2006 and account for this business as discontinued operations. As a result, certain previously reported amounts and the financial statements and related notes herein have been reclassified to conform to the current presentation. In 2006, we also divested our equity interest in a non-consolidated specialty paper mill in Switzerland. These divestitures were effected so that we could focus on our core pulp business.

Organizational Chart

The following chart sets out our directly and indirectly owned principal operating subsidiaries, their jurisdictions of organization and their principal activities:

Competitive Strengths

Our competitive strengths include the following:

Modern Low-Cost Mills. We operate three large, modern, low-cost NBSK pulp mills that produce high-quality NBSK pulp which is a premium grade of kraft pulp. The relative age and production capacity of our NBSK pulp mills provide us with certain manufacturing cost advantages over many of our competitors including lower maintenance capital expenditures. Through focused capital expenditures and other measures, we have increased the aggregate production capacity of our mills by over 133,000 ADMTs over the last two years.

Customer Proximity and Service. We are the only producer of market pulp in Germany, which is the largest pulp import market in Europe. Due to the proximity of our German mills to most of our European customers, we benefit from lower transportation costs relative to our major competitors. Our Celgar mill, located in western Canada, is well situated to serve Asian and North American customers. We primarily work directly with customers to capitalize on our geographic diversity, coordinate sales and enhance customer relationships. We believe our ability to deliver high quality pulp on a timely basis and our customer service makes us a preferred supplier for many customers.

Advantageous Capital Investments and Financing. Our German mills are eligible to receive government grants in respect of qualifying capital investments. Over the last eight years, our German mills have benefited from approximately 383.0 million of such government grants. These grants are not reported in our income but reduce the cost basis of the assets purchased when the grants are received. During the last

eight years, capital investments at our German mills have reduced the amount of overall wastewater fees that would otherwise be payable by over 37 million. Further, our Stendal mill benefits from German governmental guarantees of its project financing which permitted it to obtain better terms and lower costs than would otherwise be available. The project debt of Stendal has fixed its interest cost, including fees and margin, at a rate of approximately 5.3% per annum plus applicable margins, a 15-year term and matures in 2017. Such debt of Stendal is non-recourse to our other operations and Mercer Inc.

Renewable and Surplus Energy. Our modern mills generate electricity and steam in their boilers and are generally energy self-sufficient. Such energy is primarily produced from wood residuals which are a renewable carbon neutral source. This has permitted our German mills to benefit from the sales of emission allowances. All of our mills also generate surplus energy which we sell to third parties to reduce our operating costs. We believe our generation of renewable green energy, high energy prices and surplus power provides us with a competitive energy advantage.

Competitive Fiber Supply. Although fiber is cyclical in both price and supply, there is a significant amount of high-quality fiber within a close radius of each of our mills. This fiber supply, combined with our purchasing power, enables us to enter into contracts and arrangements which have generally provided us with a competitive fiber supply.

Corporate Strategy

Our corporate strategy is to create shareholder value by focusing on the expansion of our asset and earnings base. Key features of our strategy include:

Focusing on NBSK Market Pulp. We focus on NBSK pulp because it is a premium grade kraft pulp and generally obtains the highest price relative to other kraft pulps. Although demand is cyclical, worldwide demand for kraft market pulp has grown at an average of approximately 3% per annum over the last ten years with higher growth rates in certain markets such as Asia, in particular China, and eastern Europe.

Operating Modern, World Class Mills. In order to keep our operating costs as low as possible, with a goal of operating profitably in all market conditions, we operate large, modern NBSK pulp mills. We believe such production facilities provide us with the best platform to be an efficient, low-cost producer of high-quality NBSK pulp without the need for significant sustaining capital.

Improving Efficiency and Reducing Operating Costs. We continually focus on increasing productivity and efficiency through cost reduction initiatives and targeted capital investments. We seek to make high return capital investments that increase production and efficiency, reduce costs and improve product quality. At our German mills, certain of these capital investments qualify for government grants and some offset wastewater fees that would otherwise be payable. We also seek to reduce operating costs by better managing certain operating activities such as fiber procurement, sales and marketing and customer service. We coordinate these activities at our mills to realize on potential synergies among them.

Maximizing Energy Realizations. In 2007, our mills generated over 50 megawatts of surplus energy, primarily from a renewable carbon-neutral source. We are pursuing several initiatives to increase our overall energy generation and the amount of and price for our surplus power sales. Such initiatives include targeted high return capital projects to increase generation and connectivity to the electric grid. They also include working with stakeholders to have our surplus energy recognized as green energy and enhancing the supply of wood residuals.

Pursuing Growth. We pursue growth through organic growth and acquisitions primarily in Europe and North America. We pursue organic growth through active management and targeted capital expenditures designed to produce a high return by increasing production, reducing costs and improving quality. We seek to acquire interests in companies and assets in the pulp industry and related businesses where we can leverage our experience and expertise in adding value through a focused management approach and our global production, maintenance, procurement and sales expertise. We view these types of acquisitions, which can occur at significant discounts to replacement costs, as having the ability to generate strong value.

The Pulp Industry

General

Pulp is used in the production of paper, tissues and paper related products. Pulp is generally classified according to fiber type, the process used in its production and the degree to which it is bleached. Kraft pulp is produced through a sulphate chemical process in which lignin, the component of wood which binds individual fibers, is dissolved in a chemical reaction. Chemically prepared pulp allows the wood s fiber to retain its length and flexibility, resulting in stronger paper products. Kraft pulp can be bleached to increase its brightness. Kraft pulp is noted for its strength, brightness and absorption properties and is used to produce a variety of products, including lightweight publication grades of paper, tissues and paper related products.

The market value of kraft pulp depends in part on the fiber used in the production process. There are two primary species of wood used as fiber: softwood and hardwood. Softwood species generally have long, flexible fibers which add strength to paper while fibers from species of hardwood contain shorter fibers which lend bulk and opacity. Generally, prices for softwood pulp are higher than for hardwood pulp. Currently, the kraft pulp market is roughly evenly split between softwood and hardwood grades. Most uses of market kraft pulp, including fine printing papers, coated and uncoated magazine papers and various tissue products, utilize a mix of softwood and hardwood grades to optimize production and product qualities. In recent years, production of hardwood pulp, based on fast growing plantation fiber primarily from Asia and South America, has increased much more rapidly than that of softwood grades that have longer growth cycles. As a result of the growth in supply and lower costs, kraft pulp customers in recent years have substituted some of the pulp content in their products to hardwood pulp. Counteracting customers increased proportionate usage of hardwood pulp has been the requirement for strength characteristics in finished goods. Paper and tissue makers focus on higher machine speeds and lower basis weights for publishing papers which also require the strength characteristics of softwood pulp. We believe that the ability of kraft pulp users to further substitute hardwood for softwood pulp is limited by such requirements.

NBSK pulp, which is a bleached kraft pulp manufactured using species of northern softwood, is considered a premium grade because of its strength. It generally obtains the highest price relative to other kraft pulps. Southern bleached softwood kraft pulp is kraft pulp manufactured using southern softwood species and does not possess the strength found in NBSK pulp. NBSK pulp is the sole product of our mills.

Kraft pulp can be made in different grades, with varying technical specifications, for different end uses. High-quality kraft pulp is valued for its reinforcing role in mechanical printing papers, while other grades of kraft pulp are used to produce lower priced grades of paper, including tissues and paper related products.

Markets

We believe that over 125 million ADMTs of kraft pulp are converted annually into printing and writing papers, tissues, cartonboards and other white grades of paper and paperboard around the world. Approximately 70% of this pulp is produced for internal purposes by integrated paper and paperboard manufacturers, and approximately 30% is produced for sale on the open market.

Although demand is cyclical, worldwide demand for kraft market pulp has grown at an average rate of approximately 3% annually over the last ten years. The growth rate for NBSK pulp reflects this continuing demand.

Western Europe accounts for approximately 35% of global market pulp demand with a growth rate of approximately 1% annually over the past ten years. Within Europe, Germany, with its large economy and sizable paper industry, has historically been the largest pulp market relying largely on imports from North America and Scandinavia.

Demand for market pulp in Asia has been growing at approximately 5% annually over the past 10 years and currently accounts for approximately 34% of global demand. This demand growth has primarily been driven by increasing per capita consumption. Demand for NBSK market pulp in China has grown at a rate of approximately 15% per year over the last ten years. China, which accounted for 4% of world market kraft pulp demand in 1996 now accounts for 14% of world demand. Canada is the largest exporter to this region.

We expect Europe and Asia to continue to be significant net importers of pulp in the foreseeable future. The markets for kraft pulp are cyclical in nature and demand for kraft pulp is related to global and regional levels of economic activity. A measure of demand for kraft pulp is the ratio obtained by dividing the worldwide demand of kraft pulp by the worldwide capacity for the production of kraft pulp, or the demand/capacity ratio . An increase in this ratio generally occurs when there is an increase in global and regional levels of economic activity. An increase in this ratio generally indicates greater demand as consumption increases, which generally results in rising kraft pulp prices, a build-up of inventories by buyers and a reduction by producers. As prices continue to rise, producers continue to run at higher operating rates. However, an adverse change in global and regional levels of economic activity generally negatively affects demand for kraft pulp, often leading to a high level of inventory build-up by buyers. Falling demand is precipitated by buyers generally reducing their purchases and relying on inventories of kraft pulp, and, in turn, many producers will run at lower operating rates by taking downtime to limit the build-up of their own inventories. The demand/capacity ratio was approximately 96% in 2006 and approximately 93% in 2005.

We do not believe there are any significant new NBSK pulp production capacity increases coming online in the next several years due in part to fiber supply constraints and high capital costs.

Competition

Pulp markets are large and highly competitive. Producers ranging from small independent manufacturers to large integrated companies produce pulp worldwide. Our pulp and customer services compete with similar products manufactured and distributed by others. Many factors influence our competitive position. These factors include price, service, quality and convenience of location. Some of our competitors are larger than we are in certain markets and have greater financial resources. These resources may afford those competitors more purchasing power, increased financial flexibility, more capital resources for expansion and improvement and enable them to compete more effectively.

Our key NBSK pulp competitors are principally located in northern Europe and Canada. In 2007, our largest competitors included Södra Cell International, Canfor Pulp Income Trust and Pope & Talbot, Inc.

NBSK Pulp Pricing

Global economic conditions, changes in production capacity, inventory levels, and currency exchange rates are the primary factors affecting NBSK pulp list prices. Prices are cyclical and the average annual European list prices for NBSK pulp since 1990 have ranged from a low of approximately $444 per ADMT in 1993 to a high of approximately $985 per ADMT in 1995.

In 2005, list prices for NBSK pulp started the year at approximately $625 per ADMT but declined primarily due to the strengthening of the U.S. dollar to $600 per ADMT in Europe at the end of the year. Pulp prices increased steadily in 2006 and 2007 primarily as a result of the closure of several pulp mills, particularly in North America, which reduced NBSK capacity by approximately 1.2 million ADMTs, better demand and the general weakness of the U.S. dollar against the Euro and the Canadian dollar. At the end of 2007, list prices for NBSK pulp in Europe had increased to $870 per ADMT.

A producer s sales realizations will reflect customer discounts, commissions and other items and prices will continue to fluctuate in the future. While there are differences between NBSK list prices in Europe, North America and Asia, European prices are generally regarded as the global benchmark and pricing in other regions tends to follow European trends. The nature of the pricing structure in Asia is different in that, while quoted list prices tend to be lower than Europe, customer discounts and commissions tend to be lower resulting in net sales realizations that are generally similar to other markets.

The majority of market NBSK pulp is produced and sold by North American and Scandinavian, or Norscan , producers, while the price of NBSK pulp is generally quoted in U.S. dollars. As a result, NBSK pricing is affected by fluctuations in the currency exchange rates for the U.S. dollar versus the Canadian dollar and the Euro. NBSK pulp price increases over the last two years have in large part been offset by the weakening of the U.S. dollar.

The following chart sets out the changes in list prices for NBSK pulp in Europe and the value of the U.S. dollar to the Euro and the Canadian dollar for the periods indicated.

Price Delivered to N. Europe (C$ and equivalent indexed to 2000)

Source: RISI, Federal Reserve Bank of New York and Bank of Canada

The Manufacturing Process

The following diagram provides a simplified description of the kraft pulp manufacturing process at our pulp mills:

In order to transform wood chips into kraft pulp, wood chips undergo a multi-step process involving the following principal stages: chip screening, digesting, pulp washing, screening, bleaching and drying.

In the initial processing stage, wood chips are screened to remove oversized chips and sawdust and are conveyed to a pressurized digester where they are heated and cooked with chemicals. This occurs in a continuous process at the Celgar and Rosenthal mills and in a batch process at the Stendal mill. This process softens and eventually dissolves the phenolic material called lignin that binds the fibers to each other in the wood.

Cooked pulp flows out of the digester and is washed and screened to remove most of the residual spent chemicals, called black liquor, and partially cooked wood chips. The pulp then undergoes a series of bleaching stages where the brightness of the pulp is gradually increased. Finally, the bleached pulp is sent to the pulp machine where it is dried to achieve a dryness level of more than 90%. The pulp is then ready to be baled for shipment to customers.

A significant feature of kraft pulping technology is the recovery system, whereby chemicals used in the cooking process are captured and extracted for re-use, which reduces chemical costs and improves environmental performance. During the cooking stage, dissolved organic wood materials and black liquor are extracted from the digester. After undergoing an evaporation process, black liquor is burned in a recovery boiler. The chemical compounds of the black liquor are collected from the recovery boiler and are reconstituted into cooking chemicals used in the digesting stage through additional processing in the recausticizing plant.

The heat produced by the recovery boiler is used to generate high-pressure steam. Additional steam is generated by a power boiler through the combustion of biomass consisting of bark and other wood residues from sawmills and our woodrooms and residue generated by the effluent treatment system. Additionally, during times of

upset, we may use natural gas to generate steam. The steam produced by the recovery and power boilers is used to power a turbogenerator to generate electricity, as well as to provide heat for the digesting and pulp drying processes.

Our Product

We manufacture and sell NBSK pulp produced from wood chips and pulp logs.

The kraft pulp produced at the Rosenthal mill is a long-fibered softwood pulp produced by a sulphate cooking process and manufactured primarily from wood chips and pulp logs. A number of factors beyond economic supply and demand have an impact on the market for chemical pulp, including requirements for pulp bleached without any chlorine compounds or without the use of chlorine gas. The Rosenthal mill has the capability of producing both totally chlorine free and elemental chlorine free pulp. Totally chlorine free pulp is bleached to a high brightness using oxygen, ozone and hydrogen peroxide as bleaching agents, whereas elemental chlorine free pulp is produced by substituting chlorine dioxide for chlorine gas in the bleaching process. This substitution virtually eliminates complex chloro-organic compounds from mill effluent.

Kraft pulp is valued for its reinforcing role in mechanical printing papers and is sought after by producers of paper for the publishing industry, primarily for magazines and advertising materials. Kraft pulp produced for reinforcement fibers is considered the highest grade of kraft pulp and generally obtains the highest price. Through a focused technical and marketing effort, we have changed the mix of the kraft pulp that we produce at the Rosenthal mill to substantially increase our relative amount of reinforcement fibers from approximately 16% at the beginning of 2000 to approximately 59% at the end of 2007. The Rosenthal mill produces pulp for reinforcement fibers to the specifications of certain of our customers. We believe that a number of our customers consider us their supplier of choice. For more information about the facilities at the Rosenthal mill, see Item 2 Properties .

The kraft pulp produced at the Stendal mill is of a slightly different grade than the pulp produced at the Rosenthal mill as the mix of softwood fiber used is slightly different. This results in a complementary product more suitable for different end uses. The Stendal mill is capable of producing both totally chlorine free and elemental chlorine free pulp. For more information about the facilities at the Stendal mill, see Item 2 Properties .

The Celgar mill produces high quality kraft pulp that is made from a unique blend of slow growing/long-fiber western Canadian tree species. It is used in the manufacture of high-quality paper and tissue products. We believe the Celgar mill s pulp is known for its excellent product characteristics, including tensile strength, wet strength and brightness. The Celgar mill is a long-established supplier to paper producers in Asia. For more information about the facilities at the Celgar mill, see Item 2 Properties .

Operating Costs

Our major costs of production are labor, fiber, energy and chemicals. Fiber comprised of wood chips and pulp logs is our most significant operating expense. Given the significance of fiber to our total operating expenses and our limited ability to control its costs, compared with our other operating costs, volatility in fiber costs can materially affect our margins.

Labor

Our labor costs tend to be generally steady, with small overall increases due to inflation in wages and health care costs. Over the last three years, we have been able to generally offset such increases by increasing our efficiencies and production and streamlining operations.

Fiber

Our mills are situated in regions which generally provide a relatively stable supply of fiber. The fiber consumed by our mills consist of wood chips produced by sawmills and pulp logs, which are cyclical in both price and supply. Wood chips are small pieces of wood used to make pulp and are a by-product of either wood residuals from sawmills or logs or pulp logs chipped especially for this purpose. Pulp logs consist of lower quality logs not used in the production of lumber.

Generally, the cost of wood chips and pulp logs are primarily affected by the supply and demand for lumber. Additionally, regional factors can also have a material effect on both the supply, demand and price for fiber.

In Germany, since 2006, the price and supply of wood chips has been affected by increasing demand from alternative or renewable energy producers, changes in supply resulting from weather conditions and government initiatives and a move to increase harvesting levels. High energy prices, along with initiatives by European governments to promote the use of wood as a carbon neutral energy, have increased demand for wood usage for energy production and for wood fiber. This non-traditional demand for fiber is expected to continue and has, and will continue to, put upward pressure on fiber prices.

Weather patterns have also had a significant effect on short-term fiber supply and pricing. Severe winter storms in central Europe, including Germany, in January 2007 resulted in significant damage to the forests. We believe the damage to forests in Germany was in excess of 25 million solid cubic meters of wood. As the damaged forests were harvested as rapidly as possible to preserve the value of the wood, its availability tempered and moderated fiber prices in the second half of 2007.

Effective July 1, 2007, the Russian government raised tariffs on the export of sawmill and pulp wood to 20% and has announced that it will be implementing additional increases to 25% in April 2008. Russia has also announced it will be seeking further increases in 2009. This is expected to reduce the export of Russian wood to Europe, in particular to Scandinavian producers who import a significant amount of their wood from Russia, and is expected to put upward pressure on pricing as such producers try to replace these volumes from other regions.

Offsetting some of the increases in demand for wood fiber have been initiatives in which we and other producers are participating to increase harvest levels in Germany, particularly from small private forest owners. We believe that Germany has the highest availability of softwood forests suitable for harvesting and manufacturing. Private ownership of such forests is approximately 50%. Many of these forest ownership stakes are very small and have been harvested at rates much lower than their rate of growth.

In British Columbia, in 2007, the supply of wood fiber was materially affected by the weakness in the U.S. housing market which resulted in a significant reduction in lumber production in the Province. On the fiber demand side, although it is not nearly as advanced as Europe, there is growing interest in British Columbia for renewable or green energy. These initiatives, which are likely to increase over time, are expected to create additional competition for fiber.

We believe we are the largest consumer of wood chips and pulp logs in Germany and often provide the best, long-term economic outlet for the sale of wood chips in eastern Germany. We coordinate the wood procurement activities for our German mills to reduce overall personnel and administrative costs, provide greater purchasing power and coordinate buying and trading activities. This coordination and integration of fiber flows also allows us to optimize transportation costs, and the species and fiber mix for both mills.

In 2007, the Rosenthal mill consumed approximately 1.8 million cubic meters of fiber. Approximately 63%, or approximately 1.1 million cubic meters, of such consumption was in the form of sawmill wood chips. The balance of approximately 37%, or approximately 0.7 million cubic meters, was in the form of pulp logs. The wood chips for the Rosenthal mill are sourced from approximately 21 sawmills located in the states of Bavaria, Saxony and Thüringia and are within a 150 kilometer radius of the Rosenthal mill. Within this radius, the Rosenthal mill is the largest consumer of wood chips. Given its location and size, the Rosenthal mill is often the best economic outlet for the sale of wood chips in the area. Approximately 95% of the fiber consumed by the Rosenthal mill is spruce and the remainder is pine. While fiber costs and supply are subject to cyclical changes largely in the sawmill industry, we expect that we will be able to continue to obtain an adequate supply of fiber on reasonably satisfactory terms for the

Rosenthal mill due to its location and our long-term relationships with suppliers. We have not historically experienced any significant fiber supply interruptions at the Rosenthal mill.

Wood chips for the Rosenthal mill are normally sourced from sawmills under one year or quarterly supply contracts with fixed volumes, which provide for price adjustments. More than 85% of our chip supply is sourced from suppliers with which we have a long-standing relationship. We generally enter into annual contracts with such suppliers. Pulp logs are sourced from the state forest agencies in Thüringia, Saxony and Bavaria on a contract basis and partly from private holders on the same basis as wood chips. Like the wood chip supply arrangements, these

contracts tend to be of less than one-year terms with quarterly adjustments for market pricing. We organize the harvesting of pulp logs sourced from the state agencies in Thüringia, Saxony and Bavaria after discussions with the agencies regarding the quantities of pulp logs that we require.

In 2007, the Stendal mill consumed approximately 3.0 million cubic meters of fiber. Approximately 30% of such fiber was in the form of sawmill wood chips and approximately 70% in the form of pulp logs. The core wood supply region for the Stendal mill includes most of the northern part of Germany within an approximate 300 kilometer radius of the mill. We also purchase wood chips from southwestern and southern Germany. The fiber base in the wood supply area for the Stendal mill consisted of approximately 40% pine and 60% spruce and other species in 2007. The Stendal mill has sufficient chipping capacity to fully operate solely using pulp logs, if required. We source wood chips from sawmills within an approximate 300 kilometer radius of the Stendal mill. We source pulp logs partly from private forest holders and partly from state forest agencies in Thüringia, Saxony-Anhalt, Mecklenburg-Western Pomerania, Saxony, Lower Saxony, North Rhine-Westphalia, Hesse and Brandenburg.

Stendal has its own wood procurement division to handle its fiber requirements. This division focuses on three principal activities, being wood procurement and sales, harvesting and transportation. The procurement and sales main activity is to procure the required wood chip and pulp log assortments for the mill s annual production. In conjunction with this activity, it may also procure higher quality sawlogs, either through harvesting or through purchases that it can sell or trade with others for wood chips in order to optimize the mill s fiber mix. The harvesting activities in 2008 will focus on acquiring up to approximately 500,000 cubic meters per annum of harvestable timber, of which approximately 65% is expected to be pulp logs and the balance likely to be higher quality logs that could be sold or traded to third parties for wood chips. We currently expect that approximately 65% of this volume may be harvested directly by us and the other 35% would be contracted out to third parties.

In 2007, the Celgar mill consumed approximately 2.6 million cubic meters of fiber. Approximately 90% of such fiber was in the form of sawmill wood chips and the remaining 10% came from pulp logs processed through its woodroom. The source of fiber at the mill is characterized by a mixture of species (whitewoods and cedar) and the mill sources fiber from a number of Canadian and U.S. suppliers.

The Celgar mill has long and short-term chip supply agreements with over 30 different suppliers from Canada and the U.S., representing over 90% of its total annual fiber requirements. The woodroom supplies the remaining chips to meet the Celgar mill s fiber requirements. Chips are purchased in Canada and the U.S. in accordance with chip purchase agreements. Generally, pricing is reviewed and adjusted periodically to reflect market prices. The majority of the agreements are for periods ranging between two and five years. Several of the longer-term contracts are so-called evergreen agreements, where the contract remains in effect until one of the parties elects to terminate. Termination requires a minimum of two, and in some cases, five years written notice. Certain non-evergreen long-term agreements provide for renewal negotiations prior to expiry.

The Celgar mill has contracts with two sawmills owned by the same parent, Pope & Talbot, Inc., that, in 2007, supplied approximately 20% of its annual fiber requirements. One of these sawmills is directly adjacent to the Celgar mill. In the fourth quarter of 2007, Pope & Talbot sought and obtained creditor protection in Canada and the U.S.. As part of such creditor protection, in December 2007, Pope & Talbot announced the sale of the two sawmills to another sawmilling company, subject to customary conditions. The sale is expected to close in the first half of 2008. We cannot currently predict the new purchaser s plans for the two sawmills, including if there will be temporary or permanent closures and the effect the sale will have on our supply and cost of fiber from this source. Should operations at these sawmills be curtailed for an extended period of time or permanently, or if our fiber supply arrangements are materially altered, fiber costs and supply for our Celgar mill could be adversely impacted. However, given the proximity of the Celgar mill to these two sawmills, there is a logistical advantage to their supplying chips to the Celgar mill.

In 2007, as a result of the cyclical decline in sawmill chip availability resulting from lower lumber production in British Columbia and the weakness in the U.S. currency, the Celgar mill increased its U.S. purchases of fiber, diversified its suppliers and increased its production of chips from pulp logs processed through its woodroom by 25% compared to 2006. The woodroom at our Celgar mill can process approximately 33% of the mill s chip requirements, and alternative offsite chipping plants have been sourced. With the continuing weakness in the U.S. housing market, we currently expect to increase the amount of pulp log chipping at our Celgar mill in 2008.

To secure the volume of pulp logs required by the woodroom, the Celgar mill has entered into annual pulp log supply agreements with a number of different suppliers, many of whom are also contract chip suppliers to the mill. All of the pulp log agreements can be terminated by either party for any reason, upon seven days written notice.

Energy

Steam and electrical power are the primary forms of energy used in pulp production. Processed steam is produced in boilers using mostly renewable fuels. Our mills produce all of our steam requirements and generally generate excess energy which we sell to third party utilities. In 2007, we sold 430,437 megawatt hours of excess energy. Sales of excess energy are recorded as a reduction to production costs. These sales of surplus energy have allowed us to continually reduce our energy production costs over the last three years.

Our energy is primarily generated from renewable carbon neutral sources, such as wood waste. As a result, our German mills have benefited from the sales of emission allowances. In Europe, green energy receives a premium price compared to carbon-based energy. This recognition is also expected to develop in North America. We are pursuing a number of initiatives, including working with government to have the energy produced at our pulp mills recognized as green energy so that we may improve price realizations from surplus energy sales.

The following table sets out our electricity generation and surplus energy sales for the last three years:

Mercer Electricity Generation and Exports

Chemicals

Our pulp mills use certain chemicals which are generally available from several suppliers and sourcing is primarily based upon pricing and location. Although chemical prices have risen slightly over the last three years, we have been able to reduce our costs through improved efficiencies and capital expenditures.

Cash Production Costs

Cash production costs per tonne for our pulp mills are as follows:

Costs	Years Ended December 31, 2007	2006	2005(1)(2)
	(per ADMT)		
Fiber	247	192	171
Labor	43	46	46
Chemicals	39	42	42
Energy(3)	1	7	8
Other	46	41	40
Total cash production costs(4)	376	328	307

(1) The amounts presented are from the time of the acquisition of the Celgar mill in February 2005. Amounts in respect of the Celgar mill are included in Euros and have been converted at the average rate of exchange in 2007, 2006 and 2005, respectively, for the conversion of Canadian dollars to Euros.

(2) In 2005, the Stendal mill was ramping up production and cash production costs are not necessarily indicative of its operating capability.

(3) Net of energy revenues.

(4) Cost of production per ADMT produced excluding depreciation.

Sales, Marketing and Distribution

The distribution of our pulp sales revenues by geographic area are set out in the following table for the periods indicated:

	Years Ended December 31,(1) 2007	2006	2005
	(in thousands)		
Revenues by Geographic Area			
Germany	198,575	154,388	91,460
China	159,553	141,296	82,356
Italy	50,177	60,057	71,742
Other European Union countries(2)	136,434	117,016	91,308
Other Asia	58,242	75,522	56,953
North America	66,229	39,761	37,643

Other countries	26,639	28,586	16,191
Total(3)	695,849	616,626	447,653

(1) The data presented also includes results from the Celgar mill from the time we acquired the mill in February 2005.

(2) Not including Germany or Italy; includes new entrant countries to the European Union from their time of admission.

(3) Excluding intercompany sales volumes of nil, 13,234 and 14,289 tonnes of pulp and intercompany net sales revenues of nil, 6.4 million and 6.3 million in 2007, 2006 and 2005, respectively.

The following charts illustrate the geographic distribution of our revenues for the periods indicated:

Year Ended December 31, 2007	Year Ended December 31, 2006	Year Ended December 31, 2005

(1) Includes new entrant countries to the European Union from their time of admission.

Our global sales and marketing group has been responsible for conducting all sales and marketing of the pulp produced at our three pulp mills since 2005. This has resulted in reduced agents commissions and fees, increased contract sales and improved pulp sales realizations. About 19 employees are currently engaged full time in such activities. We coordinate and integrate the sales and marketing activities of our German mills to realize on a number of synergies between them. These include reduced overall administrative and personnel costs and coordinated selling, marketing and transportation activities. We also coordinate sales from the Celgar mill with our German mills on a global basis, thereby providing our larger customers with seamless service across all major geographies. In marketing our pulp, we seek to establish long-term relationships by providing a competitively priced, high quality, consistent product and excellent service. In accordance with customary practice, we do not have long-term sales contracts with our customers. Instead, we maintain long-standing relationships with our customers pursuant to which we periodically reach agreements on specific volumes and prices.

Our pulp sales are on customary industry terms. At December 31, 2007, we had no material payment delinquencies. In 2007, 2006 and 2005, no single customer accounted for more than 10% of our pulp sales. Our pulp sales are not dependent upon the activities of any single customer.

Our German mills are currently the only market kraft pulp producers in Germany, which is the largest import market for kraft pulp in Europe. We therefore have a competitive transportation cost advantage compared to Norscan pulp producers when shipping to customers in Europe. Due to the location of our German mills, we are able to deliver pulp to many of our customers primarily by truck. Most trucks that deliver goods into eastern Germany generally do not also haul goods out of the region as eastern Germany is primarily an importer of goods. We are therefore able to obtain relatively low back haul freight rates for the delivery of our products to many of our customers. Since many of our customers are located within a 500 kilometer radius of our German mills, we can generally supply pulp to customers of these mills faster than our competitors because of the short distances between the mills and our customers.

The Celgar mill s pulp production is transported to customers by rail, truck and ocean carrier using strategically located third party warehouses to ensure timely delivery. The majority of Celgar s pulp for overseas markets is initially delivered primarily by rail to the port of Vancouver for shipment overseas by ocean carrier. As a western Canada based pulp mill, the Celgar mill is well positioned to service Asian customers. The majority of the Celgar mill s pulp for domestic markets is shipped by rail to third party warehouses in the U.S. or directly to the customer.

Capital Expenditures

In 2007, we continued with our capital investment programs designed to increase production capacity, improve efficiency and reduce effluent discharges and emissions at our manufacturing facilities. The improvements made at

our mills over the past five years have reduced operating costs and increased the competitive position of our facilities.

Total capital expenditures at the Rosenthal mill in 2007, 2006 and 2005 were 5.2 million, 13.4 million and 7.1 million, respectively. Capital investments at the Rosenthal mill in 2007 related mainly to the installation of a new white liquor tank, and additional capacity to store sawmill chips and roundwood to better buffer against the market fluctuations of our raw materials. We estimate capital expenditures at the Rosenthal mill to be approximately 5.0 million for 2008 relating primarily to a dust filter for the lime kiln, final work on the new white liquor tank, noise reduction for the cooling towers and other smaller projects relating to maintaining the quality and efficiency of the mill. In addition, we will initiate a washer project that, among other things, is expected to offset three years of wastewater fees that would otherwise be payable. The aggregate value of the project is approximately 10 million but, after giving effect to government grants and offsetting wastewater fees, we estimate our net costs to be approximately 2.1 million.

Total capital expenditures at the Stendal mill in 2007, 2006 and 2005 were 4.9 million, 2.5 million and 8.3 million, respectively. Capital investments at the Stendal mill in 2007 related mainly to digester capacity increases. We estimate capital expenditures for the Stendal mill for 2008 to be approximately 10.0 million relating primarily to fiber handling optimization projects and equipment to increase the efficiency and capacity of the mill s black liquor production. The black liquor project is expected to increase the mill s ability to produce steam and energy. Stendal s 2008 capital expenditures include approximately 6.0 million of reliability improvements identified and funded from the 11.0 million Stendal received upon the settlement of the EPC contract in September 2007.

Certain of our capital investment programs in Germany were partially financed through government grants made available by German federal and state governments. Under legislation adopted by the federal and certain state governments of Germany, government grants are provided to qualifying businesses operating in eastern Germany to finance capital investments. The grants are made to encourage investment and job creation. Currently, grants are available for up to 15% of the cost of qualified investments. Previously, the government grants were available for up to 35% of the cost of qualified investments such as for the construction of our Stendal pulp mill. These grants with 35% of cost level required that at least one permanent job be created for each 500,000 of capital investment eligible for such grants and that such jobs be maintained for a period of five years from the completion of the capital investment project. Generally, government grants are not repayable by a recipient unless it fails to complete the proposed capital investment or, if applicable, fails to create or maintain the requisite amount of jobs. In the case of such failure, the government is entitled to revoke the grants and seek repayment unless such failure resulted from material unforeseen market developments beyond the control of the recipient, wherein the government may refrain from reclaiming previous grants. Pursuant to such legislation in effect at the time, the Stendal mill received approximately 275 million of government grants. We believe that we are in compliance in all material respects with all of the terms and conditions governing the government grants we have received in Germany.

The following table sets out for the periods indicated the effect of these government grants on the recorded value of such assets in our consolidated balance sheets:

	As at December 31,		
	2007	2006	2005
		(in thousands)	
Properties, net (as shown on consolidated balance sheets)	933,258	972,143	1,015,363
Add back: government grants less amortization, deducted from properties	304,366	341,710	327,723
	1,237,624	1,313,853	1,343,086

Properties, gross amount including government grants less amortization

Qualifying capital investments at industrial facilities in Germany to reduce effluent discharges offset wastewater fees that would otherwise be required to be paid. For more information about our environmental capital expenditures, see Environmental .

Total capital expenditures at the Celgar mill in 2007, 2006 and 2005 were 7.9 million, 16.0 million and 5.3 million, respectively. In 2007, we completed the C$28.0 million capital improvement project at the Celgar mill that commenced in 2005. The objective of this project was to reduce operating costs, increase production capacity and enhance the operating efficiency and reliability of the mill. The major components of the capital project consisted of the installation of two new compact wash presses and the expansion of one of the pulp machine dryers at an aggregate cost of approximately C$28.0 million. We estimate capital expenditures for the Celgar mill for 2008 to be approximately 5.7 million which is primarily related to reliability initiatives and environmental improvement projects.

Environmental

Our operations are subject to a wide range of environmental laws and regulations, dealing primarily with water, air and land pollution control. We devote significant management and financial resources to comply with all applicable environmental laws and regulations. Our total capital expenditures on environmental projects at our mills were approximately 0.2 million in 2007 (2006 2.0 million) and are expected to be approximately 1.6 million in 2008.

We believe we have obtained all required environmental permits, authorizations and approvals for our operations. We believe our operations are currently in substantial compliance with the requirements of all applicable environmental laws and regulations and our respective operating permits.

Under German state environmental rules relating to effluent discharges, industrial users are required to pay wastewater fees based upon the amount of their effluent discharge. These rules also provide that an industrial user which undertakes environmental capital expenditures and lowers certain effluent discharges to prescribed levels may offset the amount of these expenditures against the wastewater fees that they would otherwise be required to pay. We estimate that the aggregate wastewater fees we saved in 2007 as a result of environmental capital expenditures and initiatives to reduce allowable emissions and discharges at our Stendal pulp mill were approximately 4.1 million. In 2006, the Stendal and Rosenthal mills saved aggregate wastewater fees of approximately 7.7 million. We expect that capital investment programs and other environmental initiatives at our German mills will mostly offset the wastewater fees that may be payable for 2008 and 2009 and will ensure that our operations continue in substantial compliance with prescribed standards.

Beginning in 2005, our German operations became subject to the European Union Emissions Trading Scheme pursuant to which our German mills were granted emission allowances. Emission allowances are granted based upon production volumes and the types of fuels consumed by manufacturing facilities in Germany. Excess allowances, which are the result of variations in production volumes and the overall consumption of fuels, are available for sale.

Environmental compliance is a priority for our operations. To ensure compliance with environmental laws and regulations, we regularly monitor emissions at our mills and periodically perform environmental audits of operational sites and procedures both with our internal personnel and outside consultants. These audits identify opportunities for improvement and allow us to take proactive measures at the mills as considered appropriate.

The Rosenthal mill has a relatively modern biological wastewater treatment and oxygen bleaching facility. We have significantly reduced our levels of adsorbable organic halogen discharge at the Rosenthal mill and we believe the Rosenthal mill s adsorbable organic halogen and chemical oxygen demand discharges are in compliance with the standards currently mandated by the German government. In 2003 we completed a strategic capital project to reconstruct the landfill at the Rosenthal mill so that it will be useable for an additional 15 years.

The Stendal mill, which commenced operations in September 2004, has been in substantial compliance with applicable environmental laws, regulations and permits, but experienced certain minor exceedances during its ramp-up stage which is typical for a mill in this phase of its operations. Management believes that, as the Stendal mill is a

state-of-the-art facility, it will operate in compliance with the applicable environmental requirements.

The Celgar mill has a number of permits regulating air and effluent emissions. In March 2007, its air permit was amended to include a single limit for SO_2 from the mill. The mill has been in substantial compliance with this limit. Air permit compliance issues are achieving substantial compliance with particulate emissions from the power boiler, smelt dissolving tank and the recovery boiler. The budget for 2008 includes modifications to the electrostatic

precipitator on the recovery boiler. Upgrade plans to the power boiler have been proposed for 2009. Odor control remains a priority in 2008. Spill pond dredging is necessary to remove a considerable stockpile of solids that is responsible for generating odor. This odor will at times cause compliance issues with the air permit. Dredging of this spill pond is scheduled for the first quarter of 2008.

The Celgar mill operates two landfills, a newly commissioned site and an older site. The Celgar mill intends to decommission the old landfill and is developing a closure plan and reviewing such plan with the Ministry of Environment, or MOE . However, the MOE, in conjunction with the provincial pulp and paper industry, is in the process of developing a standard for landfill closures. In addition, the portion of the landfill owned by an adjacent sawmill continues to be active. Accordingly, the mill has not been able to move forward with the closure. We currently believe we may receive regulatory approval for such closure plan in 2008 and commence closure activities thereafter. We currently estimate the cost of closing the landfill at approximately 1.5 million but since the closure program for the old landfill has not been finalized or approved, there can be no assurance that the decommissioning of the old landfill will not exceed such cost estimate.

Future regulations or permits may place lower limits on allowable types of emissions, including air, water, waste and hazardous materials, and may increase the financial consequences of maintaining compliance with environmental laws and regulations or conducting remediation. Our ongoing monitoring and policies have enabled us to develop and implement effective measures to maintain emissions in substantial compliance with environmental laws and regulations to date in a cost-effective manner. However, there can be no assurances that this will be the case in the future.

Human Resources

We currently employ or hold positions for approximately 1,490 people. We have approximately 1,076 employees working in our German pulp operations, including our transportation subsidiaries. In addition, there are approximately 18 people working at the office we maintain in Vancouver, British Columbia, Canada. The Celgar mill currently employs approximately 396 people in its operations, the vast majority of which are unionized.

Rosenthal is bound by collective agreements negotiated with Industriegewerkschaft Bergbau Chemie, Energie, or IGBCE , a national union that represents pulp and paper workers. During the second quarter of 2007, Rosenthal concluded a new labor contract with IGBCE which represents the majority of its employees. The agreement lengthened the work week to standard industry practice which indirectly lowered wage costs by about 4% and was largely offset by a 3% wage increase in the second half of 2008. The new labor contract is set to expire at the end of 2008.

Stendal and its subsidiaries employ approximately 612 people. Pursuant to the government grants and financing arranged in connection with the Stendal mill, we have agreed with German state authorities to maintain this number of jobs until September 2010. Stendal has not yet entered into any collective agreements with IGBCE, although it may do so in the future.

We consider the relationships with our employees to be good. We have implemented profit sharing plans, training programs and early retirement schemes for the benefit of our German employees. Although no assurances can be provided, we have not had any significant work stoppages at any of our German operations and we would therefore expect to enter into labor agreements with our pulp workers in Germany without any significant work stoppages at our German mills.

A five-year collective agreement with our union hourly workers at the Celgar mill is scheduled to expire on April 30, 2008. Generally, in British Columbia, the union representing hourly pulp mill workers seeks to settle a pattern

agreement with a designated employer. Other than for local issues, this pattern agreement is usually then adopted by all pulp mill producers in the province. However, due to changing conditions in the industry, employers are moving towards customized agreements for specific mills. Although we consider our relationship with our Celgar hourly employees to be good, we can provide no assurance that a new collective agreement will be settled for the Celgar mill without significant work stoppages or disruptions.

Description of Certain Indebtedness

The following summaries of certain material provisions of: (i) our senior notes; (ii) our convertible notes; (iii) the Stendal Loan Facility; (iv) the Rosenthal Loan Facility; and (v) the Celgar Working Capital Facility, as such terms are referred to below, are not complete and these provisions, including definitions of certain terms, are qualified by reference to the applicable documents and the applicable amendments to such documents on file with the Securities and Exchange Commission, or SEC .

Senior Notes

In conjunction with the acquisition of the Celgar mill and the repayment of Rosenthal s then project loan facility, in February 2005, we issued $310.0 million in principal amount of senior notes. The senior notes bear interest at the rate of 9.25% per annum and mature on February 15, 2013. Interest on such notes is payable in arrears on February 15 and August 15 of each year the notes are outstanding. The notes are our senior unsecured obligations and, accordingly, will rank junior in right of payment to all existing and future secured indebtedness and all indebtedness and liabilities of our subsidiaries, equal in right of payment with all existing and future unsecured senior indebtedness and senior in right of payment to the 8.5% convertible senior subordinated notes due 2010 and any future subordinated indebtedness. We may redeem the notes on or after February 15, 2009, in whole or in part, at the applicable redemption prices plus accrued and unpaid interest, if any, to the redemption date. In certain circumstances, we may also redeem up to 35% of the aggregate principal amount of the notes at a redemption price of 109.35% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date with the net cash proceeds of certain equity offerings. The notes were issued under an indenture which, among other things, restricts our ability and the ability of our restricted subsidiaries under the indenture to: (i) incur additional indebtedness or issue preferred stock; (ii) pay dividends or make other distributions to our stockholders; (iii) purchase or redeem capital stock or subordinated indebtedness (unless there is no default and such purchase or redemption involves our convertible notes and the daily closing sale price per share of our common stock on the Nasdaq Global Market for a period of at least ten consecutive trading days exceeds 120% of the then applicable conversion price of such convertible notes); (iv) make investments; (v) create liens and enter into sale and lease back transactions; (vi) incur restrictions on the ability of our restricted subsidiaries to pay dividends or make other payments to us; (vii) sell assets; (viii) consolidate or merge with or into other companies or transfer all or substantially all of our assets; and (ix) engage in transactions with affiliates. These limitations are subject to other important qualifications and exceptions.

In order to take into account the nature of the non-recourse project financing of the loan facility for our Stendal mill and to enhance our financing flexibility the indenture governing our senior notes provides for a restricted group and an unrestricted group . The terms of the indenture are applicable to the restricted group and generally not applicable to the unrestricted group. Currently the restricted group is comprised of Mercer Inc., certain holding subsidiaries, and the Rosenthal and the Celgar mills. The restricted group excludes our Stendal mill. The working capital facilities at our Rosenthal and Celgar mills and our convertible and senior notes are obligations of the restricted group. The loan facility for our Stendal mill is an obligation of our unrestricted group.

Convertible Notes

In October 2003, we issued $82.5 million in aggregate principal amount of 8.5% convertible senior subordinated notes due 2010, referred to as the convertible notes . In December 2006, we purchased and cancelled an aggregate of approximately $15.2 million principal amount of such notes in exchange for approximately 2.2 million shares of our common stock.

We pay interest semi-annually on the convertible notes on April 15 and October 15 of each year, beginning on April 15, 2004. The convertible notes mature on October 15, 2010. The convertible notes are redeemable on and after October 15, 2008, at any time in whole or in part, at our option on not less than 20 and not more than 60 days prior notice at a redemption price equal to 100% of the principal amount thereof plus accrued and unpaid interest, if any, to, but not including, the date of redemption, subject to the restrictions in the indenture governing the notes.

The convertible notes are convertible, at the option of the holder, unless previously redeemed, at any time on or prior to maturity into our common shares at a conversion price of $7.75 per share, which is equal to a conversion rate of approximately 129 shares per $1,000 principal amount of convertible notes, subject to adjustment.

Holders of the convertible notes have the right to require us to purchase all or any part of the convertible notes 30 business days after the occurrence of a change of control with respect to us at a purchase price equal to the principal amount thereof plus accrued and unpaid interest, if any, to the date of purchase.

The convertible notes are unsecured obligations of Mercer Inc. and are subordinated in right of payment to existing and future senior indebtedness (including our 9.25% senior notes described below) and are effectively subordinated to all of the indebtedness and liabilities of our subsidiaries. The indenture governing the convertible notes limits the incurrence by us, but not our subsidiaries, of senior indebtedness.

Stendal Loan Facility

In August 2002, we entered into a senior project finance facility, referred to as the Stendal Loan Facility , arranged by Bayerische Hypo-und Vereinsbank AG, or HVB , pursuant to a project finance loan agreement, referred to as the Project Finance Loan Agreement , entered into between Stendal and HVB. The Stendal Loan Facility was initially established in the aggregate amount of 828.0 million and is divided into tranches which cover, among other things, project construction and development costs, financing and start-up costs and working capital, as well as the financing of a debt service reserve account, approved cost overruns and a revolving loan facility that covered time lags for receipt of grant funding and value-added tax refunds in the amount of 160.0 million, which has been repaid. Other than the revolving working capital tranche, no further advances are currently available under the Stendal Loan Facility.

Pursuant to the Project Finance Loan Agreement, interest on the credit facilities was to accrue at variable rates between Euribor plus 0.60% and Euribor plus 1.55% per year. The Project Finance Loan Agreement provides for facilities to allow us to manage our risk exposure to interest rate risk, currency risk and pulp price risk by way of interest rate swaps, Euro and U.S. dollar swaps and pulp hedging transactions, subject to certain controls, including certain maximum notional and at-risk amounts. Pursuant to the terms of the Project Finance Loan Agreement, in 2002 Stendal entered into interest rate swap agreements in respect of borrowings under the Stendal Loan Facility to fix most of the interest costs under the Stendal Loan Facility at a rate of 3.795% per year until April 2004 and 5.28% commencing May 2004, plus margin, until final payment in October 2017. For more information, see Item 7A Quantitative and Qualitative Disclosures about Market Risk .

Pursuant to the terms of the Stendal Loan Facility, Stendal reduced the aggregate advances outstanding to 565.1 million at the end of 2007 from a maximum original amount of 638.0 million. The tranches are generally repayable in installments and mature between the fifth and 15th anniversary of the first advance under the Stendal Loan Facility for project construction. Subject to various conditions, including a minimum debt service coverage test, Stendal may make distributions, in the form of interest and capital payments on shareholder debt or dividends on equity invested, to its shareholders, including us.

The tranches under the Stendal Loan Facility for project construction and development costs, financing costs, start-up costs and working capital are severally guaranteed by German federal and state governments in respect of an aggregate of 80% of the principal amount of these tranches, but the tranche under the Stendal Loan Facility for financing and start-up costs, working capital and certain of the project construction and development costs benefiting from these guarantees will be reduced semi-annually by 12.5% per year beginning on the first repayment date following the fourth anniversary of the first advance under the Stendal Loan Facility for each of these costs. Under the guarantees, the German federal and state governments that provide the guarantees are responsible for the performance of our payment obligations for the guaranteed amounts. As our Stendal Project Facility is guaranteed up to 80% pursuant to such governmental guarantees, this facility benefits from lower interest costs and other credit terms than would otherwise be available.

The Stendal Loan Facility is secured by all of the assets of Stendal.

In connection with the Stendal Loan Facility, we entered into a shareholders undertaking agreement, referred to as the Undertaking , dated August 26, 2002, as amended, with RWE AG and HVB in order to finance the shareholders contribution to the Stendal mill. Pursuant to the terms of the Undertaking, on the Stendal financing closing date the shareholders of Stendal, on a pro rata basis, subscribed for 15.0 million of share capital of Stendal and advanced to it 55.0 million in subordinated loans. In addition, on a pro rata basis, the shareholders of Stendal

advanced to it 30.0 million of stand-by equity to, among other things, cover approved cost overruns, fund the equity reserve account and partially fund the debt service reserve account under the Stendal Loan Facility. On the closing of the Stendal Loan Facility, we provided HVB with a cash deposit for our pro rata portion of such equity reserve account. Our total funding commitment under the Undertaking was 63.5 million, all of which was effected in August 2002. In 2006, when we acquired an additional 7% minority interest in Stendal, we also acquired the holder s pro rata interest in the outstanding shareholder loans and standby equity of Stendal. Pursuant to the Undertaking, we have agreed, for as long as Stendal has any liability under the Stendal Loan Facility to HVB, to retain control over at least 51% of the voting shares of Stendal. We have no further capital commitments with relation to the Stendal mill.

Rosenthal Loan Facility

In February 2005, we established a revolving working capital facility for the Rosenthal mill, referred to as the Rosenthal Loan Facility , to replace its prior project financing facility. The 40.0 million revolving working capital facility for the Rosenthal mill, arranged by HVB, consists of a revolving credit facility which may be utilized by way of cash advances or advances by way of letter of credit or bank guarantees. The facility matures in February 2010. The interest payable on cash advances is LIBOR or EURIBOR plus 1.55%, plus certain other costs incurred by the lenders in connection with the facility. Each cash advance is to be repaid on the last day of the respective interest period and in full on the termination date and each advance by way of a letter of credit or bank guarantee shall be repaid on the applicable expiry date of such letter of credit or bank guarantee. An interest period for cash advances shall be three, six or 12 months or any other period as Rosenthal and the lenders may determine. There is also a 0.35% per annum commitment fee on the unused and uncancelled amount of the revolving facility which is payable quarterly in arrears. This facility is secured by a first fixed charge on the inventories, receivables and accounts of Rosenthal. It also provides Rosenthal with a hedging facility relating to the hedging of the interest, currency and pulp prices as they affect Rosenthal pursuant to a strategy agreed to by Rosenthal and HVB from time to time.

Celgar Working Capital Facility

In May 2006, we established a C$40.0 million working capital facility for our Celgar mill, referred to as the Celgar Working Capital Facility , to replace an existing facility. This facility consists of a three-year revolving working capital credit facility maturing in May 2009. The borrower under the facility is Zellstoff Celgar Limited Partnership, which is our wholly owned subsidiary that owns the Celgar mill. Availability of drawdowns under the facility is subject to a borrowing base limit that is based upon the Celgar mill s eligible accounts receivable and inventory levels from time to time. The revolving facility is available by way of: (i) Canadian and U.S. denominated advances which bear interest at a designated prime rate plus 0.50% for Canadian advances and at a designated base rate plus 0.50% per annum for U.S. advances; (ii) banker s acceptance equivalent loans which bear interest at the applicable Canadian dollar bankers acceptance rate plus 2.25% per annum; and/or (iii) LIBOR advances which bear interest at the applicable LIBOR plus 2.25% per annum. The facility incorporates two sub lines, a $2.0 million letter of credit sub line and a $3.0 million foreign exchange contract sub line. Under these sub lines the lender will provide letters of credit guarantees and foreign exchange contract guarantees up to a maximum of $2.0 million and $3.0 million, respectively, subject, in each case, to the facility limit and payment of applicable fees. The borrower is also required to pay a 0.25% per annum standby fee monthly in arrears on any unutilized portion of the revolving facility. This facility is secured by, among other things, a first fixed charge on the current assets of the borrower.

Discontinued Operations

In August 2006, we divested our equity interest in the Heidenau paper mill and Landqart AG for cash proceeds of 5.0 million and a secured note of 5.0 million. In November 2006, we sold substantially all of the assets comprising the Fährbrücke paper mill. We recorded an aggregate net loss of 6.0 million on the disposal of these assets which included an accrual of 1.9 million for net costs expected in connection with funding and other commitments related to the

Fährbrücke sale.

Additional Information

We make available free of charge on or through our website at www.mercerint.com annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and all amendments to these reports, as soon as reasonably practicable after we file these materials with the SEC. The public may read and copy any material we file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may also obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site at www.sec.gov that also contains our current and periodic reports, including our proxy and information statements.

ITEM 1A. RISK FACTORS

This annual report on Form 10-K contains forward looking statements. Statements that are not historical or current facts, including statements about our expectations, anticipated financial results, projected capital expenditures and future business prospects, are forward looking statements. You can identify these statements by our use of words such as may , will , expect , believe , should , plan , anticipate and other similar expressions. You can find example statements throughout this annual report, including the description of business in Item 1. Business and Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations . We cannot guarantee that our actual results will be consistent with the forward looking statements we make in this annual report. You should review carefully the risk factors listed below, as well as those factors listed in other documents we file with the SEC. You are cautioned not to place undue reliance on forward looking statements. We note that additional risks not presently known to us or that we may currently deem immaterial may also impair our business and operations. Unless required by applicable law, we do not assume an obligation to update any forward looking statement.

Our business is highly cyclical in nature.

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.

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 over the last two years, we cannot predict the impact of future economic weakness in certain 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 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.

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.

Cyclical fluctuations in the price and supply of our raw materials could adversely affect our business.

Wood chips and pulp logs comprise the fiber used by our pulp mills. Such fiber is cyclical in terms of both price and supply. The cost of wood chips and pulp logs is primarily affected by the supply and demand for lumber. Demand for these raw materials is generally determined by the volume of pulp and paper products produced globally and regionally. Recently, continued high energy prices, a focus on green or renewable energy and governmental initiatives have led to an increase in renewable energy projects in Europe, including Germany. Demand for wood residuals from such energy producers has put upward pressure on prices for wood residuals such as wood chips in Germany and its neighboring countries. This has resulted in higher fiber costs for our German pulp mills and such trend could continue to put further upward pressure on wood chip prices. Similarly, North American energy producers are exploring the viability of renewable energy initiatives which could increase the demand for sawmill residual fiber, including chips. The cyclical nature of pricing for these raw materials represents a potential risk to our profit margins if pulp producers are unable to pass along price increases to their customers.

We do not own any timberlands or have any long-term governmental timber concessions nor do we have any long-term fiber contracts at our German operations. Raw materials are available from a number of suppliers and we have not historically experienced material supply interruptions or substantial sustained price increases, however our requirements have increased and may continue to increase as we increase capacity through capital projects or other efficiency measures at our mills. As a result, we may not be able to purchase sufficient quantities of these raw materials to meet our production requirements at prices acceptable to us during times of tight supply. In addition, the quality of fiber we receive could be reduced as a result of industrial disputes, material curtailments or shut-down of operations by suppliers, government orders and legislation, weather conditions, acts of god and other events beyond our control. An insufficient supply of fiber or reduction in the quality of fiber we receive would materially adversely affect our business, financial condition, results of operations and cash flow. In addition to the supply of wood fiber, we are dependent on the supply of certain chemicals and other inputs used in our production facilities. Any disruption in the supply of these chemicals or other inputs could affect our ability to meet customer demand in a timely manner and could harm our reputation. Any material increase in the cost of these chemicals or other inputs could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Our level of indebtedness could negatively impact our financial condition and results of operations.

As of December 31, 2007, we had approximately 849.9 million of indebtedness outstanding, of which 565.1 million is project debt of Stendal. We may also incur additional indebtedness in the future. Our high debt levels may have important consequences for us, including, but not limited to the following:

- our ability to obtain additional financing to fund future operations or meet our working capital needs or any such financing may not be available on terms favorable to us or at all;
- a certain amount of our operating cash flow is dedicated to the payment of principal and interest on our indebtedness, thereby diminishing funds that would otherwise be available for our operations and for other purposes;
- a substantial decrease in net operating cash flows or increase in our expenses could make it more difficult for us to meet our debt service requirements, which could force us to modify our operations; and

- our leveraged capital structure may place us at a competitive disadvantage by hindering our ability to adjust rapidly to changing market conditions or by making us vulnerable to a downturn in our business or the economy in general.

Our ability to repay or refinance our indebtedness will depend on our future financial and operating performance. Our performance, in turn, will be subject to prevailing economic and competitive conditions, as well as financial, business, legislative, regulatory, industry and other factors, many of which are beyond our control. Our ability to meet our future debt service and other obligations, in particular the Stendal project debt, may depend

in significant part on the success of the Stendal mill and the extent to which we can implement successfully our business and growth strategy. We cannot assure you that we will be able to implement our strategy fully or that the anticipated results of our strategy will be realized.

We operate in highly competitive markets.

We sell our pulp globally, with a large percentage sold in Europe, North America and Asia. The markets for pulp are highly competitive. A number of other global companies compete in each of these markets and no company holds a dominant position. For pulp, many companies produce products that are largely standardized. As a result, the primary basis for competition in our markets has been price. Many of our competitors have greater resources and lower leverage than we do and may be able to adapt more quickly to industry or market changes or devote greater resources to the sale of products than we can. There can be no assurance that we will continue to be competitive in the future. The global pulp market has historically been characterized by considerable swings in prices which have and will result in variability in our earnings. Prices are typically denominated in U.S. dollars.

We are exposed to currency exchange rate and interest rate fluctuations.

In 2007, the majority of our sales were in products quoted in U.S. dollars while most of our operating costs and expenses, other than those of the Celgar mill, were 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 have been adversely affected by the 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. This could have a material adverse effect on our business, financial condition, results of operations and cash flows.

In 2002, Stendal entered into variable-to-fixed interest rate swaps to fix interest payments under the Stendal mill financing facility, which has kept Stendal from benefiting from the general decline in interest rates that ensued. These derivatives are marked to market at the end of each reporting period and all unrealized gains and losses are recognized in earnings for the relevant reporting periods.

Increases in our capital expenditures or maintenance costs could have a material adverse effect on our cash flow and our ability to satisfy our debt obligations.

Our business is capital intensive. Our annual capital expenditures may vary due to fluctuations in requirements for maintenance, business capital, expansion and as a result of changes to environmental regulations that require capital expenditures to bring our operations into compliance with such regulations. In addition, our senior management and board of directors may approve projects in the future that will require significant capital expenditures. Increased capital expenditures could have a material adverse effect on our cash flow and our ability to satisfy our debt obligations. Further, while we regularly perform maintenance on our manufacturing equipment, key pieces of equipment in our various production processes may still need to be repaired or replaced. If we do not have sufficient funds or such repairs or replacements are delayed, the costs of repairing or replacing such equipment and the associated downtime of the affected production line could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We use derivatives to manage certain risk which has caused significant fluctuations in our operating results.

A significant amount of our sales revenue is based on pulp sales quoted in U.S. dollars while our reporting currency is Euros and our costs are predominantly in Euros and in Canadian dollars. From time to time, we use foreign currency

derivative instruments primarily to try to manage against depreciation of the U.S. dollar against the Euro.

We also use derivative instruments to limit our exposure to interest rate fluctuations. Concurrently with entering into the Stendal financing, Stendal entered into variable-to-fixed rate interest swaps for the full term of the Stendal Facility to manage its interest rate risk exposure with respect to the full principal amount of this facility.