MERCER INTERNATIONAL INC.
Form 10-Q
July 26, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2018

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______ to _______

Commission File No.: 000-51826

MERCER INTERNATIONAL INC.

(Exact name of Registrant as specified in its charter)

Washington	**47-0956945**
(State or other jurisdiction	*(I.R.S. Employer*
of incorporation or organization)	*Identification No.)*

Suite 1120, 700 West Pender Street, Vancouver, British Columbia, Canada, V6C 1G8

(Address of office)

(604) 684-1099

(Registrant s telephone number, including area code)

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of large accelerated filer , accelerated filer , non-accelerated filer , smaller reporting company and emerging growth company in Rule 12b-2 of the Exchan Act. (Check one):

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

Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The Registrant had 65,201,661 shares of common stock outstanding as at July 25, 2018.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED JUNE 30, 2018

(Unaudited)

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands of U.S. dollars, except per share data)

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Revenues	$ 346,532	$ 283,177	$ 714,435	$ 525,961
Costs and expenses				
Operating costs, excluding depreciation and amortization	271,134	230,534	525,419	403,130
Operating depreciation and amortization	22,906	20,521	46,115	39,637
Selling, general and administrative expenses	15,016	13,259	29,377	22,985
Operating income	37,476	18,863	113,524	60,209
Other income (expenses)				
Interest expense	(12,128)	(13,320)	(24,243)	(27,199)
Loss on settlement of debt (Note 4(a))			(21,515)	(10,696)
Legal cost award (Note 11(c))			(6,951)	
Other income (expenses)	(132)	137	(369)	573
Total other expenses	(12,260)	(13,183)	(53,078)	(37,322)
Income before provision for income taxes	25,216	5,680	60,446	22,887
Provision for income taxes	(8,461)	(7,784)	(18,042)	(15,265)
Net income (loss)	$ 16,755	$ (2,104)	$ 42,404	$ 7,622
Net income (loss) per common share				
Basic and diluted	$ 0.26	$ (0.03)	$ 0.65	$ 0.12
Dividends declared per common share	$ 0.125	$ 0.115	$ 0.250	$ 0.230

INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands of U.S. dollars)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
Net income (loss)	$ 16,755	$ (2,104)	$ 42,404	$ 7,622
Other comprehensive income (loss), net of taxes[1]				
Foreign currency translation adjustment	(55,807)	58,471	(39,522)	69,640
Change in unrecognized losses and prior service costs related to defined benefit pension plan	(574)	309	(728)	602
Change in unrealized gains/losses on marketable securities	26	3	27	5
Other comprehensive income (loss), net of taxes[1]	(56,355)	58,783	(40,223)	70,247
Total comprehensive income (loss)	$ (39,600)	$ 56,679	$ 2,181	$ 77,869

(1) Balances are net of tax effects of $nil in all periods.

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

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

	June 30, 2018	December 31, 2017
ASSETS		
Current assets		
Cash and cash equivalents	$ 269,482	$ 143,299
Restricted cash to redeem senior notes (Note 4(a))		317,439
Accounts receivable	190,807	206,027
Inventories	189,233	176,601
Prepaid expenses and other	12,041	8,973
Total current assets	661,563	852,339
Property, plant and equipment, net	836,116	844,848
Intangible and other assets	23,299	26,147
Deferred income tax	1,411	1,376
Total assets	$ 1,522,389	$ 1,724,710
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable and other	$ 187,532	$ 133,557
Pension and other post-retirement benefit obligations	939	985
Senior notes to be redeemed with restricted cash (Note 4(a))		295,924
Total current liabilities	188,471	430,466
Debt	699,261	662,997
Pension and other post-retirement benefit obligations	21,579	21,156
Capital leases and other	37,671	27,464
Deferred income tax	36,905	31,961
Total liabilities	983,887	1,174,044
Shareholders equity		
Common shares $1 par value; 200,000,000 authorized; 65,202,000 issued and outstanding (2017 65,017,000)	65,171	64,974
Additional paid-in capital	340,450	338,695

Retained earnings	232,105	205,998
Accumulated other comprehensive loss	(99,224)	(59,001)
Total shareholders equity	538,502	550,666
Total liabilities and shareholders equity	$ 1,522,389	$ 1,724,710

Commitments and contingencies (Note 11)
Subsequent events (Note 4(c) and Note 8)

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

MERCER INTERNATIONAL INC.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands of U.S. dollars)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
Cash flows from (used in) operating activities				
Net income (loss)	$ 16,755	$ (2,104)	$ 42,404	$ 7,622
Adjustments to reconcile net income (loss) to cash flows from operating activities				
Depreciation and amortization	23,014	20,625	46,333	39,846
Deferred income tax provision	1,204	4,196	6,016	8,405
Loss on settlement of debt			21,515	10,696
Defined benefit pension plan and other post-retirement benefit plan expense	432	540	871	1,066
Stock compensation expense	1,759	912	1,952	751
Other	1,311	(153)	2,131	525
Defined benefit pension plan and other post-retirement benefit plan contributions	(60)	(319)	(105)	(851)
Changes in working capital				
Accounts receivable	13,475	(37,426)	8,343	(43,714)
Inventories	(12,221)	(5,294)	(19,043)	4,131
Accounts payable and accrued expenses	36,906	36,954	54,933	43,835
Other	3,170	(1,846)	(3,228)	(2,842)
Net cash from (used in) operating activities	85,745	16,085	162,122	69,470
Cash flows from (used in) investing activities				
Purchase of property, plant and equipment	(28,655)	(19,743)	(44,839)	(27,907)
Purchase of intangible assets	(153)	(165)	(320)	(405)
Acquisition of Friesau Facility		(61,627)		(61,627)
Other	67	77	67	77
Net cash from (used in) investing activities	(28,741)	(81,458)	(45,092)	(89,862)
Cash flows from (used in) financing activities				
Redemption of senior notes			(317,439)	(234,945)
Proceeds from issuance of notes				250,000
Proceeds from revolving credit facilities, net	17,665	26,525	37,736	26,525
Dividend payments	(8,147)	(7,472)	(16,274)	(14,912)
Payment of interest rate derivative liability		(3,789)		(3,789)
Payment of debt issuance costs		(1,008)	(1,390)	(6,132)

Other		(771)		1,879		(1,619)		958
Net cash from (used in) financing activities		8,747		16,135		(298,986)		17,705
Effect of exchange rate changes on cash, cash equivalents and restricted cash		(9,835)		5,916		(9,300)		6,434
Net increase (decrease) in cash, cash equivalents and restricted cash		55,916		(43,322)		(191,256)		3,747
Cash, cash equivalents and restricted cash, beginning of period		213,566		187,965		460,738		140,896
Cash, cash equivalents and restricted cash, end of period	$	269,482	$	144,643	$	269,482	$	144,643
Supplemental cash flow disclosure								
Cash paid for interest	$	4,424	$	16,425	$	15,696	$	20,881
Cash paid for income taxes	$	2,742	$	2,677	$	4,220	$	5,204
Supplemental schedule of non-cash investing and financing activities								
Leased production equipment	$	12,126	$		$	12,126	$	139

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

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 1. The Company and Summary of Significant Accounting Policies

Nature of Operations and Basis of Presentation

The Interim Consolidated Financial Statements contained herein include the accounts of Mercer International Inc. (Mercer Inc.) and all of its subsidiaries (collectively the Company). The Company s shares of common stock are quoted and listed for trading on the NASDAQ Global Market.

The Interim Consolidated Financial Statements have been prepared by the Company pursuant to the rules and regulations of the United States Securities and Exchange Commission (the SEC). The year-end Consolidated Balance Sheet data was derived from audited financial statements. The footnote disclosure included herein has been prepared in accordance with accounting principles generally accepted for interim financial statements in the United States (GAAP). The unaudited Interim Consolidated Financial Statements should be read together with the audited Consolidated Financial Statements and accompanying notes included in the Company s latest Annual Report on Form 10-K for the fiscal year ended December 31, 2017. In the opinion of the Company, the unaudited Interim Consolidated Financial Statements contained herein contain all adjustments necessary for a fair statement of the results of the interim periods included. The results for the periods included herein may not be indicative of the results for the entire year.

In these Interim Consolidated Financial Statements, unless otherwise indicated, all amounts are expressed in United States dollars (U.S. dollars or $). The symbol refers to euros and the symbol C$ refers to Canadian dollars.

Use of Estimates

Preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant management judgment is required in determining the accounting for, among other things, pension and other post-retirement benefit obligations, deferred income taxes (valuation allowance and permanent reinvestment), depreciation and amortization, future cash flows associated with impairment testing for long-lived assets, the allocation of the purchase price in a business combination to the assets acquired and liabilities assumed, legal liabilities and contingencies. Actual results could differ materially from these estimates, and changes in these estimates are recorded when known.

New Accounting Pronouncements

Accounting Pronouncements Implemented

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-09, Revenue Recognition Revenue from Contracts with Customers that requires companies to recognize revenue when a customer obtains control rather than when companies have transferred substantially all risks and rewards of a good or service. Additionally, the update provides presentation and disclosure requirements which are more detailed in regards to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The

Company adopted this standard as at January 1, 2018 using the modified retrospective method. The new standard does not change the timing of when the Company recognizes revenue as the majority of the Company s revenue arises from contracts with customers in which the sale of goods is the main performance obligation. The Company s revised revenue recognition disclosure has been included in the Significant Accounting Policies and the Business Segment Information Note.

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

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

In March 2017, the FASB issued Accounting Standards Update 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post-Retirement Benefit Cost which requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. The Company adopted this standard as at January 1, 2018. For the three and six month periods ended June 30, 2018, $289 and $582 of the net benefit cost, respectively, has been recorded in other income (expenses) in the Interim Consolidated Statement of Operations. For the three and six month periods ended June 30, 2017, $376 and $736, respectively, has been reclassified from operating costs, excluding depreciation and amortization to other income (expenses) in the Interim Consolidated Statement of Operations.

In January 2018, the FASB released guidance on the accounting for tax on the global intangible low-taxed income (GILTI) provisions of the Tax Cuts and Jobs Act (the Act). The GILTI provisions impose a tax on foreign income in excess of a deemed return on tangible assets of foreign corporations. The Company has elected to treat any potential GILTI inclusions as a period cost.

Accounting Pronouncements Not Yet Implemented

In February 2016, the FASB issued Accounting Standards Update 2016-02, Leases (ASU 2016-02) which requires lessees to recognize virtually all of their leases on the balance sheet, by recording a right-of-use asset and liability. This update is effective for financial statements issued for fiscal years beginning after December 15, 2018, with early adoption permitted at the beginning of an interim or annual reporting period. The Company is currently assessing the impact the adoption of ASU 2016-02 will have on its consolidated financial statements.

In February 2018, the FASB issued Accounting Standards Update 2018-02, Income Statement - Reporting Comprehensive Income which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Act. This standard is effective for fiscal years beginning after December 15, 2018, and should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Act is recognized. The Company believes this new standard will not have an impact on its consolidated financial statements.

In June 2018, the FASB issued Accounting Standards Update 2018-07, Compensation - Stock Compensation - Improvements to Nonemployee Share-Based Payment Accounting which both clarifies and modifies accounting requirements relating to nonemployee share based payment transactions. The Company believes this new standard will not have an impact on its consolidated financial statements.

Significant Accounting Policies

Revenue Recognition

The Company recognizes revenue when obligations under the terms of a contract with its customer are satisfied; generally this occurs with the transfer of control of the products sold. Transfer of control to the customer is based on the standardized shipping terms in the contract as this determines when the Company has the right to payment, the customer has legal title to the asset and the customer has the risks of ownership. Payment terms are defined in the contract and payment is typically due within three months after control has transferred to the customer. The contracts do not have a significant financing component.

The Company has elected to exclude value added, sales and other taxes it collects concurrent with revenue-producing activities from revenues.

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

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

The Company may arrange shipping and handling activities as part of the sale of its products. The Company has elected to account for shipping and handling activities that occur after the customer has obtained control of the product as a fulfillment cost rather than as an additional promised service.

The following is a description of the principal activities from which the Company generates its revenues. For a breakdown of revenues by product and geographic location see the Business Segment Information Note.

Pulp and Lumber Revenues

For European sales sent by truck or train from the mills directly to the customer, the contracted sales terms are such that control transfers once the truck or train leaves the mill. For orders sent by ocean freighter, the contract terms state that control transfers at the time the product passes the ships rail. For North American sales shipped by truck or train, the contracts state that control transfers once the truck or train has arrived at the customer s specified location.

The transaction price is included in the sales contract and is net of customer discounts, rebates and other selling concessions.

The Company s pulp sales are to tissue and paper producers and the Company s lumber sales are to manufacturers and retailers. The Company s sales to Europe and North America are direct to the customer. The Company s pulp sales to overseas customers are primarily through third party sales agents and the Company s lumber sales to overseas customers are either direct to the customer or through third party sales agents.

By-Product Revenues

Energy sales are to utility companies in Canada and Germany. Sales of energy are recognized as the electricity is consumed by the customer and is based on contractual usage rates and meter readings that measure electricity consumption.

Chemicals and wood residuals are sold into the European market direct to the customer and have shipping terms where control transfers once the chemicals or wood residuals are loaded onto the truck at the mill.

Note 2. Inventories

	June 30,	December 31,

	2018		2017	
Raw materials	$	77,844	$	49,137
Finished goods		42,518		58,364
Spare parts and other		68,871		69,100
	$	189,233	$	176,601

Note 3. Accounts Payable and Other

	June 30, 2018		December 31, 2017	
Trade payables	$	49,175	$	36,151
Accrued expenses		90,733		67,528
Interest payable		16,505		10,093
Income tax payable		10,941		4,324
Legal cost award payable (Note 11(c))		6,951		
Dividends payable		8,150		8,126
Other		5,077		7,335
	$	187,532	$	133,557

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 4. Debt

	June 30, 2018	December 31, 2017
2022 Senior Notes, principal amount, $100,000 (a)	$ 98,780	$ 394,565
2024 Senior Notes, principal amount, $250,000 (a)	245,776	245,398
2026 Senior Notes, principal amount, $300,000 (a)	294,203	293,773
Revolving credit facilities		
75.0 million (b)		
C$40.0 million (c)		
70.0 million (d)	34,974	25,185
5.0 million (e)		
25.0 million (f)	25,528	
	$ 699,261	$ 958,921

As at June 30, 2018, the maturities of the principal portion of debt are as follows:

2018	$
2019	
2020	25,528
2021	
2022	134,974
Thereafter	550,000
	$ 710,502

Certain of the Company s debt instruments were issued under agreements which, among other things, may limit its ability and the ability of its subsidiaries to make certain payments, including dividends. These limitations are subject to specific exceptions. As at June 30, 2018, the Company is in compliance with the terms of its debt agreements.

(a) On December 20, 2017, the Company issued $300,000 in aggregate principal amount of 5.50% senior notes which mature on January 15, 2026 (2026 Senior Notes). The 2026 Senior Notes were issued at a price of 100.00% of their principal amount. The net proceeds of the offering were $293,795, after deducting the underwriter s discount and offering expenses.

In January 2018, the Company used the net proceeds, together with cash on hand, to redeem $300,000 in aggregate principal amount of 2022 Senior Notes (herein defined below). In connection with this redemption the Company recorded a loss on settlement of debt of $21,515 in the Interim Consolidated Statement of Operations. As at December 31, 2017, the total cash used to redeem the 2022 Senior Notes was classified as restricted cash and the carrying value of the 2022 Senior Notes was classified as a current liability in the Consolidated Balance Sheet.

On February 3, 2017, the Company issued $225,000 in aggregate principal amount of 6.50% senior notes which mature on February 1, 2024 (2024 Senior Notes) and on March 16, 2017, the Company issued an additional $25,000 in aggregate principal amount of its 2024 Senior Notes. The 2024 Senior Notes were issued at a price of 100.00% of their principal amount. The net proceeds of the offerings were $244,711, after deducting the underwriter s discount and offering expenses. The net proceeds from the 2024 Senior Notes, together with cash on hand, were used to redeem $227,000 of remaining aggregate principal amount of outstanding senior notes due 2019, to finance the acquisition of a German sawmill and bio-mass power plant near Friesau Germany (the Friesau Facility) and for general working capital purposes. In connection with the redemption the Company recorded a loss on settlement of debt of $10,696 in the Interim Consolidated Statement of Operations.

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 4. Debt (continued)

On November 26, 2014, the Company issued $400,000 in aggregate principal amount of 7.75% senior notes which mature on December 1, 2022 (2022 Senior Notes and collectively with the 2024 Senior Notes and 2026 Senior Notes, the Senior Notes).

The Senior Notes are general unsecured senior obligations of the Company. They rank equal in right of payment with all existing and future unsecured senior indebtedness of the Company and are senior in right of payment to any current or future subordinated indebtedness of the Company. The Senior Notes are effectively junior in right of payment to all existing and future secured indebtedness, to the extent of the assets securing such indebtedness, and all indebtedness and liabilities of the Company s subsidiaries.

The Company may redeem all or a part of the 2026 Senior Notes, upon not less than 10 days or more than 60 days notice, at the redemption prices (expressed as percentages of principal amount) discussed below, plus accrued and unpaid interest to (but not including) the applicable redemption date. The Company may redeem all or a part of the 2024 Senior Notes or 2022 Senior Notes, upon not less than 30 days or more than 60 days notice, at the redemption prices (expressed as percentages of principal amount) discussed below, plus accrued and unpaid interest to (but not including) the applicable redemption date. The 2026 Senior Notes redemption prices are equal to 102.750% for the twelve month period beginning on January 15, 2021, 101.375% for the twelve month period beginning on January 15, 2022, and 100.000% beginning on January 15, 2023 and at any time thereafter. The 2024 Senior Notes redemption prices are equal to 103.250% for the twelve month period beginning on February 1, 2020, 101.625% for the twelve month period beginning on February 1, 2021, and 100.000% beginning on February 1, 2022 and at any time thereafter. The 2022 Senior Notes redemption prices are equal to 105.813% for the twelve month period beginning on December 1, 2017, 103.875% for the twelve month period beginning on December 1, 2018, 101.938% for the twelve month period beginning on December 1, 2019, and 100.000% beginning on December 1, 2020 and at any time thereafter.

(b) A 75.0 million revolving credit facility at the Stendal mill that matures in October 2019. Borrowings under the facility are collateralized by the mill s inventory and accounts receivable and bear interest at Euribor plus 3.50%. As at June 30, 2018, approximately 2.2 million ($2,592) of this facility was supporting bank guarantees leaving approximately 72.8 million ($84,843) available.

(c) A C$40.0 million revolving credit facility at the Celgar mill that matures in May 2019. Borrowings under the facility are collateralized by the mill s inventory and accounts receivable and are restricted by a borrowing base calculated on the mill s inventory and accounts receivable. Canadian dollar denominated amounts bear interest at bankers acceptance plus 1.50% or Canadian prime. U.S. dollar denominated amounts bear interest at LIBOR plus 1.50% or U.S. base. As at June 30, 2018, approximately C$1.7 million ($1,290) was supporting letters of credit and approximately C$38.3 million ($29,086) was available.

In July 2018, the Company amended the credit facility including extending its maturity date to July 2023 and reducing the applicable margin on interest rates for Canadian and U.S. dollar denominated balances by 0.25% when the remaining borrowing capacity is greater than or equal to 25% of the total facility.

(d) A 70.0 million joint revolving credit facility that matures in April 2022. The Rosenthal mill has full access to the available amount under the facility and the Company s wholly owned subsidiary, Mercer Timber Products GmbH has access to a maximum of 45.0 million. Borrowings under the facility are collateralized by the borrowers inventory and accounts receivable and bear interest at Euribor plus 2.95%. As at June 30, 2018, approximately 30.0 million ($34,974) of this facility was drawn and accruing interest at a rate of 2.95% and approximately 11.6 million ($13,478) of this facility was supporting bank guarantees leaving approximately 28.4 million ($33,154) available.

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 4. Debt (continued)

(e) A 5.0 million revolving credit facility at the Rosenthal mill that matures in December 2018. Borrowings under this facility bear interest at the rate of the three-month Euribor plus 2.50% and are secured by certain land at the Rosenthal mill. As at June 30, 2018 approximately 2.6 million ($2,975) of this facility was supporting bank guarantees leaving approximately 2.4 million ($2,854) available.

(f) A 25.0 million revolving credit facility for the Company s wholly owned German subsidiary, Mercer Holz GmbH (Mercer Holz), that matures in February 2020. Borrowings under this facility bear interest at Euribor plus 3.30% and are secured by Mercer Holz s inventory and accounts receivable. As at June 30, 2018, approximately 21.9 million ($25,528) of this facility was drawn and accruing interest at a rate of 3.30% and approximately 0.3 million ($373) of this facility was supporting bank guarantees leaving approximately 2.8 million ($3,244) available.

Note 5. Pension and Other Post-Retirement Benefit Obligations

Defined Benefit Plans

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

Pension benefits are based on employees earnings and years of service. The Celgar Defined Benefit Plans are funded by contributions from the Company based on actuarial estimates and statutory requirements.

The components of the net benefit costs relating to the Celgar Defined Benefit Plans for the three and six month periods ended June 30, 2018 and 2017 were as follows:

	Three Months Ended June 30,			
	2018		2017	
	Pension	Other Post-Retirement Benefits	Pension	Other Post-Retirement Benefits
Service cost	$ 26	$ 117	$ 23	$ 141
Interest cost	317	178	324	229

Expected return on plan assets	(384)		(486)	
Amortization of unrecognized items	230	(52)	270	39
Net benefit costs	$ 189	$ 243	$ 131	$ 409

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 5. Pension and Other Post-Retirement Benefit Obligations (continued)

	Six Months Ended June 30,			
	2018		2017	
	Pension	Other Post-Retirement Benefits	Pension	Other Post-Retirement Benefits
Service cost	$ 52	$ 237	$ 46	$ 284
Interest cost	640	360	652	461
Expected return on plan assets	(777)		(979)	
Amortization of unrecognized items	464	(105)	527	75
Net benefit costs	$ 379	$ 492	$ 246	$ 820

Defined Contribution Plan

Effective December 31, 2008, the Celgar Defined Benefit Plans were closed to new members. In addition, the defined benefit service accrual ceased on December 31, 2008, and members began to receive pension benefits, at a fixed contractual rate, under a new defined contribution plan effective January 1, 2009. During the three and six month periods ended June 30, 2018, the Company made contributions of $217 and $435, respectively (2017 $192 and $459), to this plan.

Multiemployer Plan

The Company participates in a multiemployer plan for the hourly-paid employees at the Celgar mill. The contributions to the plan are determined based on a percentage of pensionable earnings pursuant to a collective bargaining agreement. The Company has no current or future contribution obligations in excess of the contractual contributions. During the three and six month periods ended June 30, 2018, the Company made contributions of $658 and $1,145, respectively (2017 $568 and $1,046), to this plan.

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 6. Income Taxes

The income tax provision attributable to income before provision for income taxes in the Interim Consolidated Statements of Operations differs from the amounts computed by applying the U.S. Federal statutory income tax rate of 21% (2017 - 35%) for the three and six month periods ended June 30, 2018 and 2017 as a result of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
U.S. Federal statutory rate	**21%**	**35%**	**21%**	**35%**
U.S. Federal statutory rate on income before provision for income taxes	$ (5,296)	$ (1,988)	$ (12,694)	$ (8,010)
Tax differential on foreign income	(2,639)	550	(7,228)	2,967
Effect of foreign earnings	(5,740)		(8,457)	
Change in undistributed earnings		(2,983)		(5,465)
Valuation allowance	3,773	(5,200)	22,018	(9,354)
Tax benefit of partnership structure	1,380	1,230	2,277	2,446
Non-taxable foreign subsidies	732	550	1,488	1,109
True-up of prior year taxes	(426)	(490)	(14,493)	(110)
Foreign exchange on valuation allowance	(352)	926	(674)	1,163
Foreign exchange on settlement of debt				550
Other	107	(379)	(279)	(561)
	$ (8,461)	$ (7,784)	$ (18,042)	$ (15,265)
Comprised of:				
Current income tax provision	$ (7,257)	$ (3,588)	$ (12,026)	$ (6,860)
Deferred income tax provision	(1,204)	(4,196)	(6,016)	(8,405)
	$ (8,461)	$ (7,784)	$ (18,042)	$ (15,265)

During the three month period ended June 30, 2018, the Company amended previously filed tax returns with the Canadian tax authorities. As a result, the Company reversed its unrecognized tax benefit of $16,677 recorded during the three month period ended March 31, 2018 and increased its true-up of prior year taxes. The liability related to the amendment is fully offset by a reduction in the valuation allowance and the Company did not incur any interest or penalties.

The Act enacted on December 22, 2017 resulted in substantial changes including reducing the U.S. federal corporate income tax rate from 35% to 21% and requiring companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred. The Company applied the guidance in Staff Accounting Bulletin No. 118 and at December 31, 2017 calculated its best estimate of the impact of the Act in its year end income tax provision. During the three and six month periods ended June 30, 2018, the Company did not record any measurement period adjustments to the provisional estimates recorded at December 31, 2017. Final accounting for these impacts is expected in the third quarter of 2018 subsequent to the Company s completion of the 2017 tax return.

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 7. Net Income (Loss) Per Common Share

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Net income (loss)				
Basic and diluted	$ 16,755	$ (2,104)	$ 42,404	$ 7,622
Net income (loss) per common share				
Basic and diluted	$ 0.26	$ (0.03)	$ 0.65	$ 0.12
Weighted average number of common shares outstanding:				
Basic(1)	65,140,802	64,945,675	65,095,788	64,857,300
Effect of dilutive shares:				
Performance Share Units (PSUs)	520,920		506,475	438,204
Restricted shares	20,959		26,737	22,539
Diluted	65,682,681	64,945,675	65,629,000	65,318,043

(1) For the three and six month periods ended June 30, 2018, the basic weighted average number of common shares outstanding excludes 31,130 restricted shares which have been issued, but have not vested as at June 30, 2018 (2017 43,635 restricted shares).

The calculation of diluted net income (loss) per common share does not assume the exercise of any instruments that would have an anti-dilutive effect on net income (loss) per common share. The following table summarizes the instruments excluded from the calculation of net income (loss) per common share because they were anti-dilutive:

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
PSUs		1,953,308		
Restricted shares		43,635		

Note 8. Shareholders Equity

Dividends

During the six month period ended June 30, 2018, the Company s Board of Directors declared the following quarterly dividends:

Date Declared	Dividend Per Common Share	Amount
February 15, 2018	$ 0.125	$ 8,147
May 3, 2018	0.125	8,150
	$ 0.250	$ 16,297

Dividends are paid in the quarter subsequent to the quarter in which they were declared.

In July 2018, the Company s Board of Directors declared a quarterly dividend of $0.125 per common share. Payment of the dividend will be made on October 3, 2018 to all shareholders of record on September 26, 2018. Future dividends are subject to approval by the Board of Directors and may be adjusted as business and industry conditions warrant.

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 8. Shareholders Equity (continued)

Stock Based Compensation

In June 2010, the Company adopted a stock incentive plan which provides for options, restricted stock rights, restricted shares, performance shares, PSUs and stock appreciation rights to be awarded to employees, consultants and non-employee directors. During the six month period ended June 30, 2018, there were no issued and outstanding options, restricted stock rights, performance shares or stock appreciation rights. As at June 30, 2018, after factoring in all allocated shares, there remain approximately 2.8 million common shares available for grant.

PSUs

PSUs comprise rights to receive common shares at a future date that are contingent on the Company and the grantee achieving certain performance objectives. The performance objective period is generally three years. For the three and six month periods ended June 30, 2018, the Company recognized an expense of $1,630 and $1,694, respectively related to PSUs (2017 $804 and $555).

The following table summarizes PSU activity during the period:

	Number of PSUs
Outstanding as at January 1, 2018	1,867,158
Granted	652,548
Vested and issued	(153,243)
Forfeited	(330,455)
Outstanding as at June 30, 2018	2,036,008

Restricted Shares

Restricted shares generally vest at the end of one year. Expense recognized for the three and six month periods ended June 30, 2018 was $129 and $258 (2017 $108 and $196). As at June 30, 2018, the total remaining unrecognized compensation cost related to restricted shares amounted to approximately $477 which will be amortized over the remaining vesting periods.

The following table summarizes restricted share activity during the period:

	Number of Restricted Shares
Outstanding as at January 1, 2018	43,635
Granted	31,130
Vested	(43,635)
Outstanding as at June 30, 2018	31,130

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 8. Shareholders Equity (continued)

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

	Foreign Currency Translation Adjustment	Defined Benefit Pension and Other Post-Retirement Benefit Items	Unrealized Gains / Losses on Marketable Securities	Total
Balance as at January 1, 2018	$ (50,083)	$ (8,900)	$ (18)	$ (59,001)
Other comprehensive income (loss) before reclassifications	(39,522)	(1,087)	27	(40,582)
Amounts reclassified from accumulated other comprehensive loss		359		359
Other comprehensive income (loss)	(39,522)	(728)	27	(40,223)
Balance as at June 30, 2018	$ (89,605)	$ (9,628)	$ 9	$ (99,224)

Note 9. Business Segment Information

The Company is managed based on the primary products it manufactures: pulp and wood products. Accordingly, the Company s three pulp mills are aggregated into the pulp business segment and the Friesau Facility from its acquisition date of April 12, 2017 is a separate reportable business segment, wood products.

None of the income or loss items following operating income in the Company s Interim Consolidated Statement of Operations are allocated to the segments, since those items are reviewed separately by management.

The following tables shows information by reportable business segments for the three and six month periods ended June 30, 2018 and 2017:

Three Months Ended June 30, 2018	**Pulp**	**Wood Products**	**Corporate and Other**	**Consolidated**
Revenues from external customers	$ 291,632	$ 54,900	$	$ 346,532
Operating income (loss)	$ 36,976	$ 4,322	$ (3,822)	$ 37,476
Depreciation and amortization	$ 21,127	$ 1,779	$ 108	$ 23,014
Revenues by major products				
Pulp	$ 279,939	$	$	$ 279,939
Lumber		48,991		48,991
Energy and chemicals	11,693	3,255		14,948
Wood residuals		2,654		2,654
Total revenues	$ 291,632	$ 54,900	$	$ 346,532
Revenues by geographical markets				
U.S.	$ 5,653	$ 15,249	$	$ 20,902
Germany	116,205	22,094		138,299
China	75,356			75,356
Other countries	94,418	17,557		111,975
Total revenues	$ 291,632	$ 54,900	$	$ 346,532

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 9. Business Segment Information (continued)

Three Months Ended June 30, 2017	**Pulp**	**Wood Products**	**Corporate and Other**	**Consolidated**
Revenues from external customers	$ 265,886	$ 17,291	$	$ 283,177
Operating income (loss)	$ 21,069	$ 81	$ (2,287)	$ 18,863
Depreciation and amortization	$ 19,387	$ 1,134	$ 104	$ 20,625
Revenues by major products				
Pulp	$ 244,684	$	$	$ 244,684
Lumber		13,593		13,593
Energy and chemicals	21,202	2,645		23,847
Wood residuals		1,053		1,053
Total revenues	$ 265,886	$ 17,291	$	$ 283,177
Revenues by geographical markets				
U.S.	$ 6,694	$	$	$ 6,694
Germany	103,438	11,636		115,074
China	74,779			74,779
Other countries	80,975	5,655		86,630
Total revenues	$ 265,886	$ 17,291	$	$ 283,177

Six Months Ended June 30, 2018	**Pulp**	**Wood Products**	**Corporate and Other**	**Consolidated**
Revenues from external customers	$ 605,867	$ 108,568	$	$ 714,435
Operating income (loss)	$ 111,030	$ 7,304	$ (4,810)	$ 113,524
Depreciation and amortization	$ 42,650	$ 3,465	$ 218	$ 46,333
Total assets	$ 1,351,996	$ 131,092	$ 39,301	$ 1,522,389
Revenues by major products				
Pulp	$ 570,490	$	$	$ 570,490
Lumber		97,159		97,159
Energy and chemicals	35,377	6,036		41,413
Wood residuals		5,373		5,373
Total revenues	$ 605,867	$ 108,568	$	$ 714,435

Revenues by geographical markets				
U.S.	$ 11,303	$ 31,654	$	$ 42,957
Germany	240,943	43,860		284,803
China	159,837			159,837
Other countries	193,784	33,054		226,838
Total revenues	$ 605,867	$ 108,568	$	$ 714,435

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 9. Business Segment Information (continued)

Six Months Ended June 30, 2017	Pulp	Wood Products	Corporate and Other	Consolidated
Revenues from external customers	$ 508,670	$ 17,291	$	$ 525,961
Operating income (loss)	$ 63,429	$ 81	$ (3,301)	$ 60,209
Depreciation and amortization	$ 38,503	$ 1,134	$ 209	$ 39,846
Revenues by major products				
Pulp	$ 465,496	$	$	$ 465,496
Lumber		13,593		13,593
Energy and chemicals	43,174	2,645		45,819
Wood residuals		1,053		1,053
Total revenues	$ 508,670	$ 17,291	$	$ 525,961
Revenues by geographical markets				
U.S.	$ 11,118	$	$	$ 11,118
Germany	201,463	11,636		213,099
China	133,676			133,676
Other countries	162,413	5,655		168,068
Total revenues	$ 508,670	$ 17,291	$	$ 525,961

Revenues between segments are accounted for at prices that approximate fair value. These include revenues from the sale of residual fiber from the wood products segment to the pulp segment for use in the pulp production process and from the sale of residual fuel from the pulp segment to the wood products segment for use in energy production. For the three and six month periods ended June 30, 2018, the pulp segment sold $556 and $910, respectively of residual fuel to the wood products segment (2017 - $nil) and the wood products segment sold $5,096 and $10,045, respectively of residual fiber to the pulp segment (2017 - $2,986 and $2,986).

As at December 31, 2017, the Company had total assets of $1,253,545 in the pulp segment, $116,320 in the wood products segment and $354,845 in corporate and other.

Note 10. Financial Instruments and Fair Value Measurement

Due to their short-term maturity, the carrying amounts of cash and cash equivalents, restricted cash, accounts receivable and accounts payable and other approximates their fair value.

The fair value of the senior notes classified as Level 2 was determined using quoted prices in a dealer market, or using recent market transactions.

The following tables present a summary of the Company s outstanding financial instruments and their estimated fair values under the fair value hierarchy:

	Fair value measurements as at June 30, 2018 using:			
Description	**Level 1**	**Level 2**	**Level 3**	**Total**
Revolving credit facilities	$	$ 60,502	$	$ 60,502
Senior notes		649,125		649,125
	$	$ 709,627	$	$ 709,627

MERCER INTERNATIONAL INC.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands of U.S. dollars, except share and per share data)

Note 10. Financial Instruments and Fair Value Measurement (continued)

	Fair value measurements as at December 31, 2017 using:			
Description	**Level 1**	**Level 2**	**Level 3**	**Total**
Revolving credit facilities	$	$ 25,185	$	$ 25,185
Senior notes		989,125		989,125
	$	$ 1,014,310	$	$ 1,014,310

Credit Risk

The Company s credit risk is primarily attributable to cash held in bank accounts and accounts receivable. The Company maintains cash balances in foreign financial institutions in excess of insured limits. The Company limits its credit exposure on cash held in bank accounts by periodically investing cash in excess of short-term operating requirements and debt obligations in low risk government bonds, or similar debt instruments. The Company s credit risk associated with the sale of pulp, lumber and other wood residuals is managed through setting credit limits, the purchase of credit insurance and for certain customers a letter of credit is received prior to shipping the product. Concentrations of credit risk on the sale of pulp, lumber and other wood residuals are with customers and agents based primarily in Germany, China and Italy.

The carrying amount of cash and cash equivalents of $269,482 and accounts receivable of $190,807 recorded in the Interim Consolidated Balance Sheet, net of any allowances for losses, represents the Company s maximum exposure to credit risk.

Note 11. Commitments and Contingencies

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

(b) The Company is subject to regulations that require the handling and disposal of asbestos in a prescribed manner if a property undergoes a major renovation or demolition. Otherwise, the Company is not required to remove asbestos from its facilities. Generally asbestos is found on steam and condensate piping systems as well as certain cladding on buildings and in building insulation throughout older facilities. The Company s obligation for the proper removal and disposal of asbestos products from the Company s mills is a conditional asset retirement obligation. As a result of the longevity of the Company s mills, due in part to the maintenance procedures and the fact that the Company does not have plans for major changes that require the removal of asbestos, the timing of the asbestos removal is indeterminate. As a result, the Company is currently unable to reasonably estimate the fair value of its asbestos removal and disposal obligation. The Company will recognize a liability in the period in which sufficient information is available to reasonably estimate its fair value.

(c) In March 2018, the Company announced it had received the decision of the tribunal in respect of its previously initiated claim in January 2012 against the Government of Canada under the North American Free Trade Agreement (NAFTA). The basis of the claim was that the Celgar mill had received discriminatory treatment regarding its ability to purchase and sell energy compared to other pulp mills and entities that generate and sell electricity within the Province of British Columbia. The tribunal ruled that there was no violation of NAFTA and as is customary in these matters, the tribunal awarded costs to the Government of Canada of approximately $6,951.

NON-GAAP FINANCIAL MEASURES

This quarterly report on Form 10-Q contains non-GAAP financial measures , that is, financial measures that either exclude or include amounts that are not excluded or included in the most directly comparable measure calculated and presented in accordance with the generally accepted accounting principles in the United States, referred to as GAAP . Specifically, we make use of the non-GAAP measure Operating EBITDA .

Operating EBITDA is defined as operating income (loss) plus depreciation and amortization and non-recurring capital asset impairment charges. We use Operating EBITDA as a benchmark measurement of our own operating results and as a benchmark relative to our competitors. We consider it to be a meaningful supplement to operating income as a performance measure primarily because depreciation expense and non-recurring capital asset impairment charges are not actual cash costs, and depreciation expense varies widely from company to company in a manner that we consider largely independent of the underlying cost efficiency of our operating facilities. In addition, we believe Operating EBITDA is commonly used by securities analysts, investors and other interested parties to evaluate our financial performance.

Operating EBITDA does not reflect the impact of a number of items that affect our net income (loss), including financing costs and the effect of derivative instruments. Operating EBITDA is not a measure of financial performance under GAAP, and should not be considered as an alternative to net income (loss) or income (loss) from operations as a measure of performance, or as an alternative to net cash from operating activities as a measure of liquidity. Operating EBITDA is an internal measure and therefore may not be comparable to other companies.

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

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

In this document: (i) unless the context otherwise requires, references to we , our , us , the Company or Mercer
Mercer International Inc. and its subsidiaries; (ii) references to Mercer Inc. mean the Company excluding its subsidiaries; (iii) information is provided as of June 30, 2018, unless otherwise stated; (iv) our reporting currency is dollars and references to mean euros and C$ mean Canadian dollars; (v) ADMTs refers to air-dried metric tonne (vi) MW refers to megawatts and MWh refers to megawatt hours; (vii) Mfbm refers to thousand board feet of lumbe and MMfbm mean million board feet of lumber; and (viii) our lumber metrics are converted from cubic meters to Mfbm using a conversion ratio of 1.6 cubic meters to 1 Mfbm, which is the ratio commonly used in the industry.

Due to rounding, numbers presented throughout this report may not add up precisely to totals we provide and percentages may not precisely reflect the absolute figure.

The following discussion and analysis of our results of operations and financial condition for the three and six months ended June 30, 2018 should be read in conjunction with our interim consolidated financial statements and related notes included in this quarterly report, as well as our most recent annual report on Form 10-K for the fiscal year ended December 31, 2017 filed with the Securities and Exchange Commission, referred to as the SEC .

Results of Operations

General

We have two reportable operating segments, being the pulp business and, since April 2017, the wood products business.

Each segment offers primarily different products and requires different manufacturing processes, technology and sales and marketing.

Current Market Environment

In the second quarter of 2018, pulp prices in Europe and North America increased and pulp prices in China were generally flat compared to prior quarter of 2018 due to continued steady demand, producer maintenance downtime, low customer inventories and continued lower levels of recycled fiber availability in China due to import restrictions.

Overall, our average pulp sales realizations were approximately 5% higher in the second quarter of 2018 compared to the prior quarter of 2018.

At the end of the current quarter, list prices in Europe, China and North America were approximately $1,230, $910 and $1,330 per ADMT, respectively.

Currently, the NBSK pulp market is generally balanced with world producer inventories at about 28 days supply. Looking forward, we believe the new pulp production capacity that has or is coming online will not materially adversely impact the market in the near term as a result of continued steady demand growth, producer downtime and the continued restrictions on the import of recovered or waste paper in China.

In the third quarter of 2018, we have 14 days of scheduled maintenance downtime (which will reduce production by approximately 14,800 ADMTs) at our Rosenthal mill and in the fourth quarter of 2018, we have three days of scheduled maintenance downtime (which will reduce production by approximately 5,700 ADMTs) at our Stendal mill.

In the second quarter of 2018, European and U.S. lumber markets continued to be strong with prices near multi-year highs. Looking ahead into the third quarter, we expect lumber prices to moderately adjust from their multi-year highs.

Summary Financial Highlights

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
	(in thousands, other than per share amounts)			
Pulp segment revenues	$ 291,632	$ 265,886	$ 605,867	$ 508,670
Wood products segment revenues	54,900	17,291	108,568	17,291
Total revenues	$ 346,532	$ 283,177	$ 714,435	$ 525,961
Pulp segment operating income	$ 36,976	$ 21,069[1]	$ 111,030	$ 63,429[1]
Wood products segment operating income	4,322	81	7,304	81
Corporate and other operating loss	(3,822)	(2,287)	(4,810)	(3,301)
Total operating income	$ 37,476	$ 18,863	$ 113,524	$ 60,209
Pulp segment depreciation and amortization	$ 21,127	$ 19,387	$ 42,650	$ 38,503
Wood products segment depreciation and amortization	1,779	1,134	3,465	1,134
Corporate and other depreciation and amortization	108	104	218	209
Total depreciation and amortization	$ 23,014	$ 20,625	$ 46,333	$ 39,846
Operating EBITDA[2]	$ 60,490	$ 39,488[1]	$ 159,857	$ 100,055[1]
Loss on settlement of debt	$ -	$ -	$ 21,515[3]	$ 10,696[4]
Legal cost award	$ -	$ -	$ 6,951	$ -
Provision for income taxes	$ 8,461	$ 7,784	$ 18,042	$ 15,265
Net income (loss)	$ 16,755	$ (2,104)	$ 42,404	$ 7,622
Net income (loss) per common share				
Basic and diluted	$ 0.26	$ (0.03)	$ 0.65	$ 0.12
Common shares outstanding at period end	65,202	65,017	65,202	65,017

(1) Adjusted as a result of our adoption of Accounting Standards Update 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post-Retirement Benefit Cost*, in the current year. See Note 1 to our Interim Consolidated Financial Statements.

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

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
	(in thousands)			
Net income (loss)	$ 16,755	$ (2,104)	$ 42,404	$ 7,622
Provision for income taxes	8,461	7,784	18,042	15,265
Interest expense	12,128	13,320	24,243	27,199

Loss on settlement of debt	-	-	21,515	10,696
Legal cost award	-	-	6,951	-
Other (income) expenses	132	(137)	369	(573)
Operating income	37,476	18,863	113,524	60,209
Add: Depreciation and amortization	23,014	20,625	46,333	39,846
Operating EBITDA	$ 60,490	$ 39,488	$ 159,857	$ 100,055

(3) Redemption of 7.75% senior notes due 2022, referred to as the 2022 Senior Notes .
(4) Redemption of 7.00% senior notes due 2019, referred to as the 2019 Senior Notes .

Selected Production, Sales and Other Data

	Three Months Ended June 30,		Six Months Ended June 30,	
Pulp Segment	**2018**	**2017**	**2018**	**2017**
Pulp production (000 ADMTs)	309.7	362.7	674.2	736.4
Annual maintenance downtime (000 ADMTs)	55.4	32.5	55.4	32.5
Annual maintenance downtime (days)	37	22	37	22
Pulp sales (000 ADMTs)	338.3	388.8	705.4	763.9
Average NBSK pulp list prices in Europe ($/ADMT)[1]	1,200	880	1,148	852
Average NBSK pulp list prices in China ($/ADMT)[1]	910	670	910	658
Average NBSK pulp list prices in North America ($/ADMT)[1]	1,310	1,093	1,272	1,063
Average pulp sales realizations ($/ADMT)[2]	821	624	801	604
Energy production (000 MWh)	294.7	448.7	732.7	920.9
Energy sales (000 MWh)	84.6	193.5	260.3	396.1
Average energy sales realizations ($/MWh)	99	89	104	90

	Three Months Ended June 30,		Six Months Ended June 30,	
Wood Products Segment	**2018**	**2017**	**2018**	**2017**
Lumber production (MMfbm)	112.0	67.5	215.3	67.5
Lumber sales (MMfbm)	113.1	41.5	228.2	41.5
Average lumber sales realizations ($/Mfbm)	433	328	426	328
Energy production (000 MWh)	25.6	24.0	46.2	24.0
Energy sales (000 MWh)	25.6	24.0	46.2	24.0
Average energy sales realizations ($/MWh)	127	110	131	110
Average Spot Currency Exchange Rates				
$/ [3]	1.1922	1.1008	1.2103	1.0838
$ / C$[3]	0.7750	0.7438	0.7826	0.7496

(1) Source: RISI pricing report.
(2) Sales realizations after customer discounts, rebates and other selling concessions. Incorporates the effect of pulp price variations occurring between the order and shipment dates.
(3) Average Federal Reserve Bank of New York Noon Buying Rates over the reporting period.

Consolidated - Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Total revenues for the three months ended June 30, 2018 increased by approximately 22% to $346.5 million from $283.2 million in the same quarter of 2017 primarily due to a 32% increase in pulp sales realizations and $37.6 million of higher revenues from our wood products segment.

Costs and expenses in the current quarter increased by approximately 17% to $309.1 million from $264.3 million in the second quarter of 2017 primarily due to costs associated with a 66% increase in production in our wood products segment and higher maintenance and per unit fiber costs partially offset by the impact of lower pulp sales volumes.

In the second quarter of 2018, operating depreciation and amortization increased to $22.9 million from $20.5 million in the same quarter of 2017 primarily due to the negative impact of a weaker dollar on our euro and Canadian dollar denominated depreciation expense.

Selling, general and administrative expenses increased to $15.0 million in the second quarter of 2018 from $13.3 million in the same quarter of 2017 primarily due to the impact of a higher share price on our stock compensation expense and the negative impact of a weaker dollar.

In the second quarter of 2018, our operating income increased by approximately 98% to $37.5 million from $18.9 million in the same quarter of 2017 as higher pulp sales realizations more than offset lower energy and pulp sales volumes and higher maintenance and per unit fiber costs.

Interest expense in the current quarter decreased to $12.1 million from $13.3 million in the same quarter of 2017 primarily as a result of a lower interest rate on our outstanding senior notes.

During the second quarter of 2018, income tax expense increased to $8.5 million from $7.8 million in the same quarter of 2017 due to higher taxable income for our German mills.

For the second quarter of 2018, our net income increased to $16.8 million, or $0.26 per share, from a net loss of $2.1 million, or $0.03 per share, in the same quarter of 2017.

In the second quarter of 2018, Operating EBITDA increased by approximately 53% to $60.5 million from $39.5 million in the same quarter of 2017 as higher pulp sales realizations more than offset lower energy and pulp sales volumes and higher maintenance and per unit fiber costs.

Operating Results by Business Segment

None of the income or loss items following operating income in our Interim Consolidated Statement of Operations are allocated to our segments, since those items are reviewed separately by management.

Pulp Segment - Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Selected Financial Information

	Three Months Ended June 30,			
	2018		2017	
	(in thousands)			
Pulp revenues	$	279,939	$	244,684
Energy and chemical revenues	$	11,693	$	21,202
Depreciation and amortization	$	21,127	$	19,387
Operating income	$	36,976	$	21,069

Pulp revenues in the second quarter of 2018 increased by approximately 14% to $279.9 million from $244.7 million in the same quarter of 2017 due to higher sales realizations partially offset by lower sales volumes.

Energy and chemical revenues decreased by approximately 45% to $11.7 million in the second quarter of 2018 from $21.2 million in the same quarter of 2017 due to lower production as a result of the maintenance downtime. Additionally, one of the turbines at the Stendal mill was taken offline for a scheduled major maintenance in April and did not resume service until late July 2018.

Pulp production decreased by approximately 15% to 309,668 ADMTs in the current quarter from 362,665 ADMTs in the same quarter of 2017. In the current quarter of 2018, we had an aggregate of 37 days (approximately 55,400 ADMTs) of annual maintenance downtime, of which 25 days (approximately 36,300 ADMTs) was at our Celgar mill and 12 days (approximately 19,100 ADMTs) was at our Stendal mill. The 25 days of maintenance downtime at the Celgar mill included 11 unplanned days primarily to complete additional identified maintenance inside the recovery boiler. This contributed to a slower restart of the mill than planned. In the second quarter of 2017, we had an aggregate of 22 days (approximately 32,500 ADMTs) of annual maintenance downtime, of which 20 days (approximately 28,700 ADMTs) was at our Celgar mill and two days (approximately 3,800 ADMTs) was at our Stendal mill.

We estimate that annual maintenance downtime in the current quarter adversely impacted our operating income by approximately $59.1 million, comprised of approximately $36.6 million in direct out-of-pocket expenses and the balance in reduced production. Many of our competitors that report their financial results using International Financial Reporting Standards (IFRS) capitalize their direct costs of maintenance downtime.

Pulp sales volumes decreased by approximately 13% to 338,308 ADMTs in the current quarter from 388,792 ADMTs in the same quarter of 2017 primarily due to lower production.

In the current quarter of 2018, list prices for NBSK pulp increased from the same quarter of 2017, largely as a result of overall steady demand. Average list prices for NBSK pulp in Europe were approximately $1,200 per ADMT in the second quarter of 2018 compared to approximately $880 per ADMT in the same quarter of 2017. Average list prices for NBSK pulp in China and North America were approximately $910 per ADMT and $1,310 per ADMT, respectively, in the current quarter compared to approximately $670 per ADMT and $1,093 per ADMT, respectively, in the same quarter of 2017. NBSK pulp prices are cyclical and are at or near record highs.

Average pulp sales realizations increased by approximately 32% to $821 per ADMT in the second quarter of 2018 from approximately $624 per ADMT in the same quarter of 2017 primarily due to higher list prices.

As a result of the effect of the dollar strengthening at the end of the current quarter against the euro and Canadian dollar on our dollar denominated cash and receivables held at our operations, we recorded a net overall positive impact of approximately $1.5 million due to foreign exchange despite the negative impact of a weaker dollar on costs and expenses during the current quarter.

Costs and expenses for our pulp segment in the current quarter increased by approximately 4% to $255.2 million from $244.8 million in the second quarter of 2017 primarily due to higher maintenance and per unit fiber costs partially offset by the impact of lower sales volumes.

In the second quarter of 2018, pulp segment operating depreciation and amortization increased to $21.1 million from $19.4 million in the same quarter of 2017 primarily due the negative impact of a weaker dollar on our euro and Canadian dollar denominated depreciation expense.

On average, in the current quarter overall per unit fiber costs increased by approximately 19% from the same quarter of 2017 primarily as a result of the negative impact of a weaker dollar on our euro and Canadian dollar denominated fiber costs and strong demand. In the current quarter low producer inventories caused by unfavorable winter harvesting conditions and strong demand resulted in the higher prices. We currently expect a moderate decline in per unit fiber costs in the third quarter of 2018 as a result of improved harvesting conditions.

Transportation costs for our pulp segment decreased by approximately 12% to $17.6 million in the current quarter from $20.1 million in the same quarter of 2017 primarily due to lower sales volumes.

In the second quarter of 2018, pulp segment operating income increased by approximately 75% to $37.0 million from $21.1 million in the same quarter of 2017 as higher pulp sales realizations more than offset lower sales volumes, higher maintenance costs and higher per unit fiber costs.

Wood Products Segment - Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Selected Financial Information

	Three Months Ended June 30,	
	2018	2017
	(in thousands)	
Lumber revenues	$ 48,991	$ 13,593
Energy revenues	$ 3,255	$ 2,645
Wood residual revenues	$ 2,654	$ 1,053
Depreciation and amortization	$ 1,779	$ 1,134
Operating income	$ 4,322	$ 81

We entered into the wood products business on April 12, 2017.

In the second quarter of 2018, lumber revenues increased to $49.0 million from $13.6 million, due to higher sales volume and higher sales realizations. In the current quarter approximately 22% of sales volumes were in the U.S. market and substantially all remaining sales were in Europe, which such sales are generally made in euros.

Energy and wood residual revenues increased to $5.9 million in the second quarter of 2018 from $3.7 million in the same quarter of 2017 primarily due to higher sales volumes and the positive impact of a weaker dollar on our euro denominated revenues.

Production increased to 112.0 MMfbm of lumber in the current quarter from 67.5 MMfbm in the same quarter of 2017.

Average lumber sales realizations increased by approximately 32% to $433 per Mfbm in the second quarter of 2018 from approximately $328 per Mfbm in the same quarter of 2017 primarily due to higher prices in Europe and increased sales to the U.S. where we realized higher sale prices.

Fiber costs are approximately 80% of our cash production costs. In the current quarter per unit fiber costs increased by approximately 17% from the same quarter of 2017 primarily as a result of the negative impact of a weaker dollar on our euro denominated fiber costs and strong demand. In the current quarter low producer inventories caused by unfavorable winter harvesting conditions and strong demand resulted in higher prices. We currently expect a moderate decline in per unit fiber costs in the third quarter of 2018 as a result of improved harvesting conditions.

In the second quarter of 2018, lumber segment operating depreciation and amortization increased to $1.8 million from $1.1 million in the same quarter of 2017 primarily due to the acquisition of production equipment.

Transportation costs for our wood products segment increased to $5.9 million in the current quarter from $0.8 million in the same quarter of 2017 primarily due to higher sales volumes and higher sales to the U.S.

In the second quarter of 2018, our wood products segment operating income increased to $4.3 million from $0.1 million in the same quarter of 2017 primarily due to higher lumber sales realizations partially offset by higher transportation and per unit fiber costs.

Consolidated - Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017

Total revenues for the first half of 2018 increased by approximately 36% to $714.4 million from $526.0 million in the first half of 2017 primarily due to a 33% increase in pulp sales realizations and the inclusion of an additional $91.3 million of wood products segment revenues.

Costs and expenses in the first half of 2018 increased by approximately 29% to $600.9 million from $465.8 million in the first half of 2017 primarily due to additional costs and expenses from our wood products segment, the negative impact of a weaker dollar on our euro denominated costs and expenses and higher maintenance and per unit fiber costs partially offset by lower pulp sales volumes.

In the first half of 2018, operating depreciation and amortization increased to $46.1 million from $39.6 million in the same period of 2017 primarily due to the negative impact of a weaker dollar on our euro denominated depreciation expense and the inclusion of depreciation for the wood products segment for the full period.

Selling, general and administrative expenses increased to $29.4 million in the first half of 2018 from $23.0 million in the same period of 2017 primarily due to the inclusion of our wood products segment for the full period and the negative impact of a weaker dollar.

In the first half of 2018, operating income increased by approximately 89% to $113.5 million from $60.2 million in the same period of 2017 as higher pulp sales realizations more than offset lower energy and pulp sales volumes, the negative impact of a weaker dollar on our euro denominated costs and expenses and higher maintenance and per unit fiber costs.

In December 2017, we issued $300.0 million of 5.50% senior notes due 2026, referred to as the 2026 Senior Notes and, on January 5, 2018, we utilized the proceeds, together with cash on hand, to redeem $300.0 million of our 7.75% senior notes due 2022 at a cost, including premium, of $317.4 million and recorded a loss on such redemption of $21.5 million (being $0.33 per share).

Interest expense in the first half of 2018 decreased to $24.2 million from $27.2 million in the same period of 2017 primarily as a result of a lower interest rate on our outstanding senior notes.

In the first half of 2018, we recognized an expense of $7.0 million, or $0.11 per share, in connection with the legal cost award made by the tribunal in our claim against the Government of Canada under the North American Free Trade Agreement, referred to as NAFTA .

During the first half of 2018, income tax expense increased to $18.0 million from $15.3 million in the same period of 2017 due to higher taxable income for our German mills.

For the first half of 2018, after giving effect to costs of $28.5 million, or $0.44 per basic and $0.43 per diluted share, for the redemption of senior notes and the NAFTA legal cost award, our net income increased to $42.4 million, or $0.65 per share, from $7.6 million, or $0.12 per share, after giving effect to costs of $10.7 million for the redemption of senior notes in the same period of 2017.

In the first half of 2018, Operating EBITDA increased by approximately 60% to $159.9 million from $100.1 million in the same period of 2017 as higher pulp sales realizations more than offset lower energy and pulp sales volumes, the negative impact of a weaker dollar relative to the euro and higher maintenance and per unit fiber costs.

Pulp Segment Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017

Selected Financial Information

	Six Months Ended June 30,			
	2018		2017	
	(in thousands)			
Pulp revenues	$	570,490	$	465,496
Energy and chemical revenues	$	35,377	$	43,174
Depreciation and amortization	$	42,650	$	38,503
Operating income	$	111,030	$	63,429

Pulp revenues in the first half of 2018 increased by approximately 23% to $570.5 million from $465.5 million in the same period of 2017 due to higher sales realizations partially offset by lower sales volumes.

Energy and chemical revenues decreased by approximately 18% to $35.4 million in the first half of 2018 from $43.2 million in the same period of 2017 due to lower production as a result of the maintenance downtime. Additionally, one of the turbines at the Stendal mill was taken offline for a scheduled major maintenance commencing in April and did not resume service until late July 2018.

Pulp production decreased by approximately 8% to 674,154 ADMTs in the first half of 2018 from 736,430 ADMTs in the same period of 2017. We had annual maintenance of 37 days (approximately 55,400 ADMTs) in the first half of 2018, compared to 22 days (approximately 32,500 ADMTs) in the first half of 2017.

We estimate that annual maintenance downtime in the first half of 2018 adversely impacted our operating income by approximately $59.1 million, comprised of approximately $36.6 million in direct out-of-pocket expenses and the balance in reduced production. Many of our competitors that report their financial results using IFRS capitalize their direct costs of maintenance downtime.

Pulp sales volumes decreased by approximately 8% to 705,382 ADMTs in the first half of 2018 compared to 763,896 ADMTs in the same period of 2017 primarily due to lower production.

In the first half of 2018, list prices for NBSK pulp increased from the same period of 2017, largely as a result of continued steady demand. Average list prices for NBSK pulp in Europe were approximately $1,148 per ADMT in the first half of 2018, compared to approximately $852 per ADMT in the same period of 2017. Average list prices for NBSK pulp in China and North America were approximately $910 per ADMT and $1,272 per ADMT, respectively, in the first half of 2018, compared to approximately $658 per ADMT and $1,063 per ADMT, respectively, in the first half of 2017.

Average pulp sales realizations increased by approximately 33% to $801 per ADMT in the first half of 2018 from approximately $604 per ADMT in the same period of 2017 primarily due to higher list prices.

In the first half of 2018, the dollar was weaker against the euro which increased the dollar cost of our euro denominated costs and expenses and contributed to a negative foreign exchange impact on operating income of approximately $19.9 million when compared to the same period of the prior year.

Costs and expenses in the first half of 2018 increased by approximately 11% to $495.7 million from $445.2 million in the first half of 2017 primarily due to the negative impact of a weaker dollar on our euro denominated costs and expenses and higher maintenance and per unit fiber costs partially offset by lower sales volumes.

In the first half of 2018, depreciation and amortization increased to $42.7 million from $38.5 million in the same period of 2017 primarily due the negative impact of a weaker dollar on our euro denominated depreciation expense.

On average, in the first half of 2018 overall per unit fiber costs increased by approximately 24% from the same period of 2017 primarily as a result of the negative impact of a weaker dollar on our euro and Canadian dollar denominated fiber costs, increased demand from Scandinavian pulp mills in our European fiber procurement areas resulting from weather and lower harvesting activities. Harvesting activities in both Germany and British Columbia were impacted by short-term interruptions resulting from unseasonably wet winter conditions. Additionally, in British Columbia, sawmills focused harvesting activities on rebuilding low sawlog inventories resulting from the 2017 summer wildfires and unfavorable winter harvesting conditions, which resulted in lower pulp log availability. We expect a moderate decline in per unit fiber costs in the third quarter of 2018 as a result of improved harvesting conditions.

Transportation costs for our pulp segment were $37.4 million in the first half of 2018, flat when compared to the same period of 2017 as the decrease due to lower sales volume was offset by the negative impact of a weaker dollar on our euro and Canadian dollar denominated transportation costs.

In the first half of 2018, pulp segment operating income increased by approximately 75% to $111.0 million from $63.4 million in the same period of 2017 primarily due to higher pulp sales realizations partially offset by lower sales volumes, higher per unit fiber costs, the negative impact of a weaker dollar relative to the euro and higher maintenance costs.

Wood Products Segment - Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017

Selected Financial Information

	Six Months Ended June 30,	
	2018	2017
	(in thousands)	
Lumber revenues	$ 97,159	$ 13,593
Energy revenues	$ 6,036	$ 2,645
Wood residual revenues	$ 5,373	$ 1,053
Depreciation and amortization	$ 3,465	$ 1,134
Operating income	$ 7,304	$ 81

We entered into the wood products business on April 12, 2017.

In the first half of 2018, lumber revenues were $97.2 million, of which approximately 24% of sales volumes were in the U.S. market and substantially all remaining sales were in Europe, which such sales are made in euros. European and U.S. lumber markets were generally strong with prices steady and near multi-year highs during the first half of 2018.

In the first half of 2018, lumber production increased to 215.3 MMfbm from 67.5 MMfbm in the prior period of 2017.

In the first six months of 2018, lumber sales volumes increased to 228.2 MMfbm from 41.5 MMfbm in the same period of 2017.

In the first half of 2018, average lumber sales realizations increased by 30% to $426 per Mfbm from $328 per Mfbm in the same period of 2017.

In the first half of 2018, energy and other by-product revenues increased to $11.4 million from $3.7 million in the first six months of 2017.

Our fiber costs were approximately 80% of our cash production costs. Unseasonably wet winter weather conditions in Germany resulted in lower harvesting activities and high fiber costs in the first half of 2018 compared to the same period of 2017. As harvesting activities increase we expect modestly lower fiber costs in the third quarter of 2018.

In the first half of 2018, depreciation and amortization for our wood products segment was $3.5 million compared to $1.1 million in the first half of 2017.

In the first half of 2018, our wood products segment operating income increased to approximately $7.3 million from $0.1 million in the same period of 2017.

Liquidity and Capital Resources

Summary of Cash Flows

	Six Months Ended June 30,	
	2018	2017
	(in thousands)	
Net cash from operating activities	$ 162,122	$ 69,470
Net cash used in investing activities	(45,092)	(89,862)
Net cash from financing activities	18,453[(1)]	17,705
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(9,300)	6,434
Net increase in cash, cash equivalents and restricted cash	$ 126,183	$ 3,747

(1) Excludes cash of $317.4 million used for the redemption of 2022 Senior Notes.

Cash Flows from Operating Activities. We operate in a cyclical industry and our operating cash flows vary accordingly. Our principal operating cash expenditures are for labor, fiber, chemicals and debt service. Working capital levels fluctuate throughout the year and are affected by maintenance downtime, changing sales patterns, seasonality and the timing of receivables and sales and the payment of payables and expenses.

Cash provided by operating activities was $162.1 million in the six months ended June 30, 2018 and $69.5 million in the comparative period of 2017. An increase in accounts payable and accrued expenses provided cash of $54.9 million, including the legal cost award in our NAFTA claim, in the first half of 2018 compared to $43.8 million in the same period of 2017. An overall increase in inventories used cash of $19.0 million in the first half of 2018 compared to a decrease in inventories providing cash of $4.1 million in the same period of 2017. A decrease in accounts receivable provided cash of $8.3 million in the first half of 2018 compared to an increase in accounts receivable using cash of $43.7 million in the same period of 2017.

Cash Flows from Investing Activities. Investing activities in the six months ended June 30, 2018 used cash of $45.1 million primarily related to capital expenditures of $44.8 million. In the first half of 2018, capital expenditures included spending on large maintenance projects, improvements to the digester performance at our Celgar mill, a project to reduce nitrogen in wastewater at our Stendal mill and the replacement of mobile equipment, planer mill upgrades and saw line optimization at our Friesau Facility. In the same period of 2017, investing activities used cash of $89.9 million, primarily related to the acquisition of our Friesau Facility for $61.6 million and capital expenditures of $27.9 million. In the first half of 2017, capital expenditures primarily related to a rail car acceptance system for logs and additional land for raw material storage at our Rosenthal mill, a pre-bleach press system upgrade and large maintenance projects at our Celgar mill and various other smaller projects.

Cash Flows from Financing Activities. In the first half of 2018, financing activities used cash of $299.0 million primarily in connection with the redemption of the 2022 Senior Notes, which used cash of $317.4 million. In the first half of 2018, advances of $37.7 million on our revolving credit facilities were used primarily to finance wood procurement activities. In the first half of 2018, we paid dividends of $16.3 million and $1.4 million of debt issuance costs related to the 2026 Senior Notes. In the same period of 2017, financing activities provided cash of $17.7 million, including an aggregate of $250.0 million from the issuance of our 6.50% senior notes due 2024, referred to as the 2024 Senior Notes , which was primarily used to redeem our 2019 Senior Notes at a cost of $234.9 million. In the first half of 2017, debt issuance costs for the 2024 Senior Notes used cash of $6.1 million and dividend payments used cash of $14.9 million and a scheduled payment in respect of our interest rate derivative used cash of $3.8 million. In the first half of 2017, we also drew $26.5 million on our 70.0 million revolving credit facility to partially finance the acquisition of the Friesau Facility and the build in working capital associated with its ramp up of operations.

Balance Sheet Data

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

	June 30, 2018	December 31, 2017
	(in thousands)	
Financial Position		
Cash and cash equivalents	$ 269,482	$ 143,299[(1)]
Working capital	$ 473,092	$ 421,873
Total assets	$ 1,522,389	$ 1,407,271[(1)]
Long-term liabilities	$ 795,416	$ 743,578
Total equity	$ 538,502	$ 550,666

(1) Excludes restricted cash of $317.4 million held to redeem $300.0 million of 2022 Senior Notes on January 5, 2018.

As a result of the strengthening of the dollar versus the euro and Canadian dollar as at June 30, 2018, we recorded a net non-cash decrease in the carrying value of our net assets, consisting primarily of our fixed assets denominated in euros and Canadian dollars. This non-cash decrease of approximately $39.5 million does not affect our net income (loss), Operating EBITDA or cash flows but is reflected in our other comprehensive income (loss) and as a decrease to our total equity.

Sources and Uses of Funds

Our principal sources of funds are cash flows from operations and cash and cash equivalents on hand. Our principal uses of funds consist of operating expenses, capital expenditures and semi-annual interest payments on our outstanding senior notes.

The following table sets out our total capital expenditures and interest expense for the periods indicated:

	Six Months Ended June 30,	
	2018	2017
	(in thousands)	
Capital expenditures	$ 44,839	$ 27,907
Cash paid for interest expense[(1)]	$ 15,696	$ 20,881
Interest expense[(2)]	$ 24,243	$ 27,199

(1) Amounts differ from interest expense which includes non-cash items. See supplemental disclosure of cash flow information from our Interim Consolidated Statement of Cash Flows included in this report.

(2) Interest on our 2022 Senior Notes is paid semi-annually in June and December of each year. In January 2018, we redeemed $300.0 million of our 2022 Senior Notes. Interest on our 2024 Senior Notes is paid semi-annually in February and August of each year and interest on our 2026 Senior Notes is paid semi-annually in January and July of each year, commencing July 2018.

In the first half of 2018, we expended $16.3 million to pay quarterly dividends of $0.125 per common share.

As at June 30, 2018, our cash and cash equivalents increased to $269.5 million from $143.3 million at the end of 2017. As at June 30, 2018, we had approximately $153.2 million available under our revolving credit facilities.

Based upon the current level of operations and our current expectations for future periods in light of the current economic environment, and in particular, current and expected pulp and lumber pricing and foreign exchange rates, we believe that cash flow from operations and available cash, together with available borrowings under our revolving credit facilities, will be adequate to finance the capital requirements for our business including the payment of our quarterly dividend during the next 12 months.

As at June 30, 2018, we had no material commitments to acquire assets or operating businesses.

In the future we may make acquisitions of businesses or assets or commitments to additional capital projects. To achieve the long-term goals of expanding our assets and earnings, including through acquisitions, capital resources will be required. Depending on the size of a transaction, the capital resources that will be required can be substantial. The necessary resources will be generated from cash flow from operations, cash on hand, borrowing against our assets or the issuance of securities.

Debt Covenants

Certain of our long-term obligations contain various financial tests and covenants customary to these types of arrangements. See our annual report on Form 10-K for the fiscal year ended December 31, 2017.

As at June 30, 2018, we were in full compliance with all of the covenants of our indebtedness.

Off-Balance Sheet Arrangements

At June 30, 2018, we did not have any off-balance sheet arrangements (as defined in Item 303(a)(4)(ii) of Regulation S-K).

Contractual Obligations and Commitments

There were no material changes outside the ordinary course to any of our material contractual obligations during the six months ended June 30, 2018.

Foreign Currency

As a majority of our assets, liabilities and expenditures are held or denominated in euros or Canadian dollars, our consolidated financial results are subject to foreign currency exchange rate fluctuations.

We translate foreign denominated assets and liabilities into dollars at the rate of exchange on the balance sheet date. Equity accounts are translated using historical exchange rates. Unrealized gains or losses from these translations are recorded in other comprehensive income (loss) and do not affect our net earnings.

As a result of the strengthening of the dollar versus the euro and Canadian dollar as at June 30, 2018, we recorded a net non-cash decrease of $39.5 million in the carrying value of our net assets, consisting primarily of our fixed assets denominated in euros and Canadian dollars. As a result, our accumulated other comprehensive loss increased to $99.2 million.

Based upon the exchange rate as at June 30, 2018, the dollar has strengthened by approximately 3% against the euro and by approximately 5% against the Canadian dollar since December 31, 2017. See Quantitative and Qualitative Disclosures about Market Risk .

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect both the amount and the timing of the recording of assets, liabilities, revenues, and expenses in the consolidated financial statements and accompanying note disclosures. Our management routinely makes judgments and estimates about the effects of matters that are inherently uncertain. As the number of variables and assumptions affecting the probable future resolution of the uncertainties increases, these judgments become even more subjective and complex.

Our significant accounting policies are disclosed in Note 1 to our audited annual financial statements included in our annual report on Form 10-K for the fiscal year ended December 31, 2017. While all of the significant accounting policies are important to the consolidated financial statements, some of these policies may be viewed as having a high degree of judgment. On an ongoing basis using currently available information, management reviews its estimates, including those related to accounting for, among other things, pension and other post-retirement benefit obligations, deferred income taxes (valuation allowance and permanent reinvestment), depreciation and amortization, future cash flows associated with impairment testing for long-lived assets, the allocation of the purchase price in a business combination to the assets acquired and liabilities assumed, legal liabilities and contingencies. Actual results could differ materially from these estimates, and changes in these estimates are recorded when known.

We have identified certain accounting policies that are the most important to the portrayal of our current financial condition and results of operations.

For information about both our significant and critical accounting policies, see our annual report on Form 10-K for the fiscal year ended December 31, 2017.

Cautionary Statement Regarding Forward-Looking Information

The statements in this report that are not reported financial results or other historical information are forward-looking statements within the meaning of the *Private Securities Litigation Reform Act of 1995*, as amended.

Generally, forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words such as expects , anticipates , intends , plans , believes , seeks , es words of similar meaning, or future or conditional verbs, such as will , should , could , or may , although not forward-looking statements contain these identifying words. Forward-looking statements are based on expectations, forecasts and assumptions by our management and involve a number of risks, uncertainties and other factors, many of which are beyond our control, that could cause actual conditions, events or results to differ significantly from those described in the forward-looking statements. These factors include, but are not limited to, the following:

our business is highly cyclical in nature;

a weakening of the global economy, including capital and credit markets, could adversely affect our business and financial results and have a material adverse effect on our liquidity and capital resources;

our level of indebtedness could negatively impact our financial condition, results of operations and liquidity;

cyclical fluctuations in the price and supply of our raw materials, particularly fiber, could adversely affect our business;

we face intense competition in our markets;

we are exposed to currency exchange rate fluctuations;

we are subject to extensive environmental regulation and we could incur substantial costs as a result of compliance with, violations of or liabilities under applicable environmental laws and regulations;

our business is subject to risks associated with climate change and social and government responses thereto;

our operations require substantial capital and we may be unable to maintain adequate capital resources to provide for such capital requirements;

our acquisition of the Friesau Facility and other future acquisitions may result in additional risks and uncertainties in our business;

fluctuations in prices and demand for lumber could adversely affect our business;

adverse housing market conditions may increase the credit risk from customers of our Friesau Facility;

our Friesau Facility s lumber products are vulnerable to declines in demand due to competing technologies or materials;

changes in credit ratings issued by nationally recognized statistical rating organizations could adversely affect our cost of financing and have an adverse effect on the market price of our securities;

we rely on government grants and participate in German statutory energy programs;

we are subject to risks related to our employees;

we are dependent on key personnel;

we may experience material disruptions to our production;

- if our long-lived assets become impaired, we may be required to record non-cash impairment charges that could have a material impact on our results of operations;

- we may incur losses as a result of unforeseen or catastrophic events, including the emergence of a pandemic, terrorist attacks or natural disasters;

- our insurance coverage may not be adequate;

- we rely on third parties for transportation services;

- we periodically use derivatives to manage certain risks which has caused significant fluctuations in our operating results;

- failures or security breaches of our information technology systems could disrupt our operations and negatively impact our business;

- the price of our common stock may be volatile;

- a small number of our shareholders could significantly influence our business;

- our international sales and operations are subject to applicable laws relating to trade, export controls and foreign corrupt practices, the violation of which could adversely affect our operations;

- we are exposed to interest rate fluctuations; and

- political uncertainty, the rise of populist political parties and an increase in trade protectionism could have a material adverse effect on global macro-economic activities and trade and adversely affect our business, results of operations and financial condition.

Given these uncertainties, you should not place undue reliance on our forward-looking statements. The forgoing review of important factors is not exhaustive or necessarily in order of importance and should be read in conjunction with the risks and assumptions including those set forth in reports and other documents we have filed with or furnished to the SEC, including in our annual report on Form 10-K for the fiscal year ended December 31, 2017. We advise you that these cautionary remarks expressly qualify in their entirety all forward-looking statements attributable to us or persons acting on our behalf. Unless required by law, we do not assume any obligation to update forward-looking statements based on unanticipated events or changed expectations. However, you should carefully review the reports and other documents we file from time to time with the SEC.

Cyclical Nature of Business

Revenues

The pulp and lumber businesses are highly cyclical in nature and markets are characterized by periods of supply and demand imbalance, which in turn can materially affect prices. Pulp and lumber markets are sensitive to cyclical changes in the global economy, industry capacity and foreign exchange rates, all of which can have a significant influence on selling prices and our operating results. The length and magnitude of industry cycles have varied over time but generally reflect changes in macro-economic conditions and levels of industry capacity. Pulp and lumber are commodities that are generally available from other producers. Because commodity products have few distinguishing qualities from producer to producer, competition is generally based upon price, which is generally determined by supply relative to demand.

Industry capacity can fluctuate as changing industry conditions can influence producers to idle production capacity or permanently close 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. Certain integrated pulp and paper producers have the ability to discontinue paper production by idling their paper machines and selling their NBSK pulp production on the market, if market conditions, prices and trends warrant such actions.

Demand for each of pulp and lumber has historically been determined primarily by general global macro-economic conditions and has been closely tied to overall business activity. NBSK pulp prices have been and are likely to continue to be volatile and can fluctuate widely over time. Between 2008 and 2018, European list prices for NBSK pulp have fluctuated between a low of approximately $575 per ADMT in 2009 to a high of $1,230 per ADMT in 2018.

Our mills and operations voluntarily subject themselves to third-party certification as to compliance with internationally recognized, sustainable management standards because end use paper and lumber customers have shown an increased interest in understanding the origin of products they purchase. Demand for our products could be adversely affected if we, or our suppliers, are unable to achieve compliance, or are perceived by the public as failing to comply, with these standards or if our customers require compliance with alternate standards for which our operations are not certified.

A producer s actual sales price realizations are list prices net of customer discounts, rebates and other selling concessions. Over the last three years, these have increased as producers compete for customers and sales.

Accordingly, prices for pulp and lumber 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 prices for pulp and lumber, prices may fall below our cash production costs, requiring us to either incur short-term losses on product sales or cease production at one or more of our mills. Therefore, our profitability depends on managing our cost structure, particularly raw materials which represent a significant component of our operating costs and can fluctuate based upon factors beyond our control. If the prices of our products decline, or if prices for our raw materials increase, or both, our results of operations and cash flows could be materially adversely affected.

Costs

Our production costs are influenced by the availability and cost of raw materials, energy and labor, and our plant efficiencies and productivity. Our main raw material is fiber in the form of wood chips, pulp logs and sawlogs. Wood chip, pulp log and sawlog costs are primarily affected by the supply of, and demand for, lumber and pulp, which are both highly cyclical. Higher fiber prices could affect producer profit margins if they are unable to pass along price increases to pulp and lumber customers or purchasers of surplus energy.

Currency

We have manufacturing operations in Germany and Canada. Most of the operating costs and expenses of our German mills are incurred in euros and those of our Celgar mill in Canadian dollars. However, the majority of our sales are in products quoted in dollars. Our results of operations and financial condition are reported in dollars. As a result, our costs generally benefit from a strengthening dollar but are adversely affected by a decrease in the value of the dollar relative to the euro and to the Canadian dollar. Such declines in the dollar 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks from changes in interest rates and foreign currency exchange rates, particularly the exchange rates between the dollar and the euro and Canadian dollar. Changes in these rates may affect our results of operations and financial condition and, consequently, our fair value. We seek to manage these risks through internal risk management policies as well as the periodic use of derivatives.

For additional information, please refer to Part II, Item 7A. Quantitative and Qualitative Disclosures about Market Risk included in our annual report on Form 10-K for the fiscal year ended December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

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

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

Changes in Internal Controls

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to routine litigation incidental to our business, including that which is described in our latest annual report on Form 10-K for the fiscal year ended December 31, 2017. We do not believe that the outcome of such litigation will have a material adverse effect on our business or financial condition.

ITEM 1A. RISK FACTORS

There have been no material changes to the factors disclosed in Item 1A. Risk Factors in our annual report on Form 10-K for the fiscal year ended December 31, 2017, other than the addition of the risk factor in item (i) below and the update in item (ii) below:

(i) ***Political uncertainty, the rise of populist political parties and an increase in trade protectionism could have a material adverse effect on global macro-economic activities and trade and adversely affect our business, results of operations and financial condition.***

The current rise of populist political parties, economic nationalist sentiments and trade protectionism has led to increasing political uncertainty and unpredictability throughout the world. In 2016, the United Kingdom held a referendum at which the electorate voted to leave the Council of the European Union (the EU). It is unclear whether any other EU member states will hold such referendums, but such referendums could result in one or more other countries leaving the EU or in major reforms being made to the EU. The current U.S. presidential administration has publicly stated its intention to renegotiate or withdraw from the NAFTA and imposed tariffs on various goods from various countries, including China, Canada and those in the EU and announced intentions to impose further more significant tariffs. These potential developments, market perceptions concerning these and related issues and the attendant regulatory uncertainty regarding, for example, the posture of governments with respect to international trade, could have a material adverse effect on global trade and economic growth which, in turn can adversely affect our business, results of operation and financial condition.

The rise of populist political parties in some countries and the dominance of single-party political power in other countries may also lead to increased trade barriers, trade protectionism and restrictions on trade. Increased trade protectionism could materially adversely affect our business. If the current continuing global recovery is undermined by downside risks and there is a prolonged economic downturn, governments, especially populist governments, may turn to trade barriers to protect their domestic industries against imports, thereby depressing demand. Changes in U.S. trade policy, such as the announcement of unilateral tariffs on imported products, have already triggered retaliatory actions from affected countries, resulting in trade wars that could have a material adverse effect on global trade and economic growth.

Protectionist developments, or the perception they may occur, may have a material adverse effect on global economic conditions, and may significantly reduce global trade. Increasing trade protectionism in the markets could increase the risks associated with exporting goods to such markets. These developments could have a material adverse effect on our business, results of operations and financial condition.

(ii) ***We rely on government grants and participate in German statutory energy programs.***
Our German mills, including our pulp mills, sell surplus green energy at fixed prices or tariffs pursuant to the Renewable Energy Act.

In 2014, in response to an investigation by the European Commission into whether portions of such Act constituted unpermitted state aid, the German government amended the same, which amendments permitted our German mills to continue to sell green energy into the market at stipulated prices or tariffs and were exempted, as existing installations , from certain surcharges on the consumption of energy that they generate, or auto-generation .

The German government further amended the Renewable Energy Act effective January 1, 2017, so that funding for renewable energy is to be allocated through an auction system, primarily to create a competitive bidding process for new installations of wind, solar and biomass energy. Our Friesau Facility s tariff expires in 2029. However, the amendments provide that existing pulp mills, including our German pulp mills, are ineligible for such auction process and instead will have their tariffs renewed upon expiry of their initial 20-year terms for a further 10-year period, based upon the price received in the last year prior to renewal regressing at a rate of 8% per annum. Our Rosenthal mill s initial 20-year tariff expires on December 31, 2019 and our Stendal mill s initial 20-year tariff expires on December 31, 2024. Such 10-year extensions for such pulp mills have been notified by the German government to the European Commission for review for compliance with applicable state aid rules. We have been advised by German governmental authorities that such extensions may not be permitted under EU rules. As a result, we cannot currently predict whether such promulgated amendments to the Renewable Energy Act will become effective. If they do not become effective, we cannot predict what further resulting amendments the German government may put into effect and their effect on our German mills sale or consumption of energy after the expiry of their current terms of December 31, 2019 for Rosenthal and December 31, 2024 for Stendal.

Our costs of energy for our pulp operations in Germany could increase in the event that the auto-generation surcharge exemption is removed or reduced in the future. Additionally, if the stipulated tariffs for energy sold by our German mills are reduced in the future or sales are on an auction or market basis, we cannot provide assurances that our energy sales in Germany will be as profitable. Any of the foregoing situations or any combination of them could have a material adverse effect on our results of operations.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit No.	Description
10.1	Third Amended and Restated Credit Agreement dated as of July 16, 2018 among Zellstoff Celgar Limited Partnership, as borrower, and the lenders from time to time parties thereto, as lenders, and Canadian Imperial Bank of Commerce, as agent.
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1*	Section 906 Certification of Chief Executive Officer
32.2*	Section 906 Certification of Chief Financial Officer
101	The following financial statements from the Company s Form 10-Q for the fiscal period ended June 30, 2018, formatted in XBRL: (i) Interim Consolidated Statements of Operations; (ii) Interim Consolidated Statements of Comprehensive Income (Loss); (iii) Interim Consolidated Balance Sheets; (iv) Interim Consolidated Statements of Cash Flows; and (v) Notes to Interim Consolidated Financial Statements.

* In accordance with Release No. 33-8212 of the SEC, these Certifications: (i) are furnished to the SEC and are not filed for the purposes of liability under the Securities Exchange Act of 1934, as amended; and (ii) are not to be subject to automatic incorporation by reference into any of the Company s registration statements filed under the Securities Act of 1933, as amended, for the purposes of liability thereunder or any offering memorandum, unless the Company specifically incorporates them by reference therein.

SIGNATURES

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

MERCER INTERNATIONAL INC.

By: /s/ David M. Gandossi
David M. Gandossi
Chief Executive Officer and President

Date: July 26, 2018