

MERCER INTERNATIONAL INC
 Form 424B5
 February 10, 2005

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PROSPECTUS SUPPLEMENT
 (To prospectus dated December 23, 2004)

Registration No. 333-121172
 Filed Pursuant to Rule 424(b)(5)

\$310,000,000
MERCER INTERNATIONAL INC.
9.25% Senior Notes due 2013

We are offering \$310,000,000 principal amount of senior notes. We will pay interest on the notes on February 15 and August 15 of each year the notes are outstanding, beginning on August 15, 2005. The notes will bear interest at 9.25% per annum and will mature on February 15, 2013. We may redeem the notes on or after February 15, 2009, in whole or in part, at the redemption prices described in this prospectus supplement. See "Description of the Notes - Optional Redemption".

The notes are unsecured and rank equally with all of our other existing and future unsecured senior debt. The notes will be effectively junior to our secured indebtedness and the indebtedness and other liabilities of our subsidiaries. The notes will be issued only in registered form in denominations of \$1,000.

Concurrently with this offering, we are also conducting a separate public offering of approximately 9.4 million shares of beneficial interest by means of a separate prospectus supplement, pursuant to which we have granted an option for the underwriters to purchase up to approximately an additional 1.4 million shares of beneficial interest to cover over-allotments, if any. This option may be exercised on or before the 30th day after the date of the related prospectus supplement. The completion of this offering and the offering of our shares of beneficial interest are contingent upon each other.

Investing in the notes involves a number of risks, including risks that are described in the "Risk Factors" section beginning on page S-23 of this prospectus supplement and page 8 of the accompanying prospectus.

	Price to Investors ⁽¹⁾	Underwriting Discount	Proceeds, Before Expenses, to Mercer
Per senior note	100%	2.5%	97.5%
Total	\$310,000,000	\$7,750,000	\$302,250,000

(1) Plus accrued interest from February 14, 2005, if settlement occurs after that date.

Neither the Securities and Exchange Commission, referred to as the "SEC", nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus supplement. Any representation to the contrary is a criminal offense.

All of the notes will be delivered in book-entry form through The Depository Trust Company on or about February 14, 2005.

Joint Book-Running Managers

RBC Capital Markets

Credit Suisse First Boston

Co-Manager

CIBC World Markets

The date of this prospectus supplement is February 8, 2005.

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You should rely only on the information contained or incorporated by reference in this prospectus supplement. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. This document is in two parts. The first part is a prospectus supplement, which describes the specific terms of this offering and other matters relating to us and our financial condition. The second part is the accompanying prospectus, dated December 23, 2004, which gives more general information about securities we may offer from time to time, some of which may not apply to the senior notes we are currently offering. If the description of this offering or the operations presented varies between this prospectus supplement and the accompanying prospectus, you should rely on the information in this prospectus supplement. You should assume that the information appearing in this prospectus supplement and the accompanying prospectus, as well as the information contained in any document incorporated by reference, is accurate as of the date of each such document only, unless the information specifically indicates that another date applies.

The distribution of this prospectus supplement and the accompanying prospectus, and the offering of the notes, may be restricted by law in certain jurisdictions. You should inform yourself about, and observe, any of these restrictions. This prospectus supplement and the accompanying prospectus do not constitute, and may not be used in connection with, an offer or solicitation by anyone in any jurisdiction in which the offer or solicitation is not authorized, or in which the person making the offer or solicitation is not qualified to do so, or to any person to whom it is unlawful to make the offer or solicitation.

We are not offering to sell any of our shares of beneficial interest with this prospectus supplement. We will offer our shares of beneficial interest only by means of a separate prospectus supplement.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This prospectus supplement, including the information incorporated by reference into this prospectus supplement, contains "forward-looking statements". They can be identified by words such as "estimates", "projects", "scheduled", "anticipates", "expects", "intends", "plans", "will", "should", "believes", "goal", "seek", "strategy" or their negatives or other comparable words. These statements are subject to a number of risks and uncertainties including the risks and uncertainties outlined under "Risk Factors", many of which are beyond our control. We wish to caution the reader that these forward-looking statements are only estimates or predictions, such as statements regarding:

development of our business;

demand and prices for our products; and

future capital expenditures.

We do not undertake any obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Although we believe that our plans, intentions and expectations reflected in or suggested by the forward-looking statements we make in this prospectus supplement are reasonable, we can give no assurance that such plans, intentions or expectations will be achieved. Actual events or results may differ materially due to risks facing us or due to actual facts differing from the assumptions underlying our predictions. Some of these risks and assumptions include:

our level of indebtedness;

the cyclical nature of our business;

our ability to fully implement our business plan with relation to the development and expansion of our operations as planned, including with respect to the Celgar and Stendal pulp mills;

our ability to integrate and improve the operations of the Celgar pulp mill;

our ability to manage our capital expenditures and maintenance costs;

our ability to efficiently and effectively manage our growth;

our exposure to interest rate and currency exchange rate fluctuations;

our use of derivatives;

fluctuations in the price and supply of our raw materials;

our ability to respond to increasing competition;

environmental legislation and environmental risks associated with conditions at our facilities;

our ability to negotiate acceptable agreements with our employees;

our dependence upon German federal and state grants and guarantees;

our dependence upon key personnel;

potential disruptions to our production and delivery;

difficulties or delays in providing certifications under the Sarbanes-Oxley Act of 2002;

our insurance coverage; and

other regulatory, legislative and judicial developments,

any of which could cause actual results to vary materially from anticipated results.

We advise the reader that these cautionary remarks expressly qualify in their entirety all forward-looking statements attributable to us or persons acting on our behalf. Important factors that you should also consider, include, but are not limited to, the factors discussed under "Risk Factors" in this prospectus supplement and the accompanying prospectus.

MARKET AND INDUSTRY DATA

In this prospectus supplement, we rely on and refer to information and statistics regarding our market share and the markets in which we compete. We have obtained some of this market share and industry data from internal surveys, market research, publicly available information and industry publications. Such reports generally state that the information contained therein has been obtained from sources believed to be reliable, but the accuracy or completeness of such information is not guaranteed. Although we believe this information is reliable, neither we nor the underwriters have independently verified or can guarantee the accuracy or completeness of that information.

EXCHANGE RATES

As of January 1, 2002, we changed our reporting currency from the U.S. dollar to the Euro, as a significant majority of our business transactions are originally denominated in Euros. Accordingly, our financial statements for the years ended December 31, 2002 and 2003 and the nine months ended September 30, 2003 and 2004 included in this prospectus supplement are stated in Euros and our financial statements and other financial information for periods prior to the year ended December 31, 2002 included in this prospectus supplement have been restated in Euros. We translate non-Euro denominated assets and liabilities at the rate of exchange on the balance sheet date. Revenues and expenses are translated at the average rate of exchange prevailing during the period.

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

	Year Ended December 31,					Nine Months Ended September 30,	
	1999	2000	2001	2002	2003	2003	2004
	(€/€)						
End of period	0.9937	1.0646	1.1227	0.9536	0.7938	0.8584	0.8053
High for period	0.9984	1.2087	1.1945	1.1638	0.9652	0.9652	0.8474
Low for period	0.8422	0.9697	1.0487	0.9536	0.7938	0.8425	0.7780
Average for period	0.9430	1.0901	1.1219	1.0660	0.8838	0.9001	0.8158
	(C\$/€)						
End of period	1.4440	1.4995	1.5926	1.5800	1.2923	1.3506	1.2649
High for period	1.4440	1.4349	1.4932	1.5108	1.2923	1.3348	1.2649
Low for period	1.5302	1.5600	1.6023	1.6129	1.5751	1.5751	1.3970
Average for period	1.4828	1.4870	1.5518	1.5704	1.3916	1.4267	1.3280

On February 8, 2005 the Noon Buying Rate for the conversion of Euros and Canadian dollars to U.S. dollars was €0.7823 per U.S. dollar and C\$1.2476 per U.S. dollar.

In addition, the financial statements and certain financial information relating to Stone Venepal (Celgar) Pulp Inc. included in this prospectus supplement are stated in Canadian dollars while we report our financial results in Euros. The following table sets out exchange rates, based on the noon rates as provided by the Bank of Canada, for the conversion of Canadian dollars to Euros in effect at the end of the following periods, the average exchange rates during these periods (based on daily noon rates) and the range of high and low exchange rates for these periods:

	Year Ended December 31,					Nine Months Ended September 30,	
	1999	2000	2001	2002	2003	2003	2004
	(C\$/€)						
End of period	1.4525	1.4092	1.4185	1.6564	1.6280	1.5734	1.5700
High for period	1.4525	1.2538	1.2640	1.3682	1.4967	1.4967	1.5563
Low for period	1.8123	1.5047	1.4641	1.6564	1.6643	1.6643	1.6915
Average for period	1.5847	1.3707	1.3868	1.4832	1.5826	1.5875	1.6281

On February 8, 2005, the noon rate for the conversion of Canadian dollars to Euros was C\$1.5952 per Euro.

INFORMATION ABOUT STONE VENEPAL (CELGAR) PULP INC.

Information in this prospectus supplement relating to Stone Venepal (Celgar) Pulp Inc. and its operations is based on information provided by KPMG Inc. as receiver and trustee for Celgar. While we believe such information to be accurate in all material respects, neither we nor the underwriters have verified the accuracy or completeness of such information and neither we nor the underwriters represent that any such information, or the information derived therefrom, included in this prospectus supplement is accurate or complete.

In this prospectus supplement, please note the following:

references to "we", "our", "us" or the "Company" mean Mercer International Inc. and its subsidiaries, after giving effect to the acquisition of the Celgar mill, unless the context clearly suggests otherwise; references to "Mercer" mean Mercer International Inc. and its subsidiaries, without giving effect to the acquisition of the Celgar mill, unless the context clearly suggests otherwise; and references to "Mercer Inc." mean Mercer International Inc. excluding its subsidiaries;

information is provided as of September 30, 2004, unless otherwise stated;

"€" refers to Euros, the lawful currency adopted by most members of the European Union, unless otherwise stated; "\$" refers to U.S. dollars; and "C\$" refers to Canadian dollars; and

except as otherwise indicated, all information in this prospectus supplement assumes that the underwriters have not exercised their over-allotment option with respect to the offering of our shares of beneficial interest.

Unless the context clearly suggests otherwise, this prospectus supplement has been prepared to give pro forma effect to the following:

the acquisition of the Celgar mill;

this offering;

the offering of our shares of beneficial interest;

the establishment of two new revolving working capital facilities; and

the payment of estimated financing and transaction costs.

PROSPECTUS SUPPLEMENT

SUMMARY

This summary highlights certain information contained elsewhere or incorporated by reference in this prospectus supplement. Because it is a summary, it is not complete and does not contain all the information you will need to make your investment decision. You should read this entire prospectus supplement as well as the information incorporated by reference into this prospectus supplement carefully, including the section entitled "Risk Factors", before deciding to invest. On November 22, 2004, we agreed to acquire a pulp mill located near Castlegar, British Columbia, Canada, which we refer to as the "Celgar mill", that produces northern bleached softwood kraft, or "NBSK", pulp. Unless the context otherwise requires, this prospectus supplement has been prepared to give pro forma effect to the proposed acquisition of the Celgar mill, which we refer to as the "Acquisition", this offering, the offering of our shares of beneficial interest, the establishment of two new revolving working capital facilities and the payment of estimated financing and transaction costs.

Our Company

We are one of the largest market NBSK pulp producers in the world. We will have a consolidated annual production capacity of approximately 1.3 million air-dried metric tonnes, or "ADMTs", when we complete the Acquisition. We manufacture and sell high quality NBSK pulp, which is considered a premium grade of kraft pulp because of its strength and it generally obtains the highest price relative to other kraft pulps. We are the sole kraft pulp producer, and the only producer of pulp for resale, known as "market pulp", in Germany, which is the largest pulp import market in Europe. With the acquisition of the Celgar mill, the locations of our pulp mills will allow us to service many of our customers on a global basis. We also operate two paper facilities in Germany focused primarily on the production of value-added specialty papers.

Our wholly-owned subsidiary, Rosenthal, owns and operates a modern, efficient, ISO 9002 certified NBSK pulp mill in Germany. In late 1999, we completed a major capital project which converted the Rosenthal mill to the production of NBSK pulp from sulphite pulp and increased its annual production capacity from approximately 160,000 ADMTs to approximately 280,000 ADMTs, and subsequently to approximately 310,000 ADMTs. The aggregate cost of the project was approximately €361.0 million. The project was financed through a combination of a project loan supported by government guarantees, government grants totaling approximately €101.7 million and an equity investment made by us. We believe that it was the fastest start-up of a large-scale NBSK pulp facility to date. We believe that the Rosenthal mill is one of the lowest-cost producers globally of NBSK pulp delivered to Europe with average cash production costs of €300 per ADMT in the nine months ended September 30, 2004. As a result of significant local demand and favorable transportation economics, the majority of our NBSK pulp production at the Rosenthal mill is sold in Germany and other European markets.

In September 2004, our 63.6% owned subsidiary, Stendal, completed construction of a new, "greenfield", state-of-the-art, single-line NBSK pulp mill in Germany with a designed annual production capacity of approximately 552,000 ADMTs. Once operating at capacity, we believe the Stendal mill will be one of the largest NBSK pulp mills in Europe. The Stendal mill was constructed under a €716.0 million fixed-price turn-key engineering, procurement and construction, or "EPC", contract between Stendal and RWE Industrie-Lösungen GmbH, or "RWE". Construction of the Stendal mill commenced in August 2002 and was completed substantially on its planned schedule and budget. The aggregate cost of the Stendal project is approximately €1.0 billion. The Stendal project was financed through a combination of government grants totaling approximately €274.5 million, low cost, long-term project debt which is largely severally guaranteed by the federal government of Germany and the state government of Sachsen-Anhalt, and equity contributions. The commissioning of the Stendal mill commenced in the third quarter of 2004 and production is expected to reach approximately 80% of

rated capacity during the first year and to exceed 90% in the second year thereafter. The Stendal mill has been designed to produce pulp with cash production costs below those of the Rosenthal mill. We expect synergies arising from the operation of both the Stendal and the Rosenthal mills, which are located approximately 300 kilometers apart, in the areas of raw materials and supplies procurement, production engineering, sales, maintenance and marketing.

As a result of the Acquisition, we will also operate a modern NBSK pulp mill located near Castlegar, British Columbia, Canada. The Celgar mill has a current annual production capacity of approximately 430,000 ADMTs. It was completely rebuilt in the early 1990s through an C\$850 million modernization and expansion project, which transformed it into a low-cost producer. Based on an industry survey, we believe that the Celgar mill ranks in the second quartile in North America on a manufactured cost basis for NBSK pulp and it had average cash production costs of C\$533 per ADMT in the nine months ended September 30, 2004. The Celgar mill's geographic location will allow us to leverage existing relationships with European customers that also have facilities in North America and Asia. Furthermore, we believe that there are significant opportunities to enhance the financial and operating performance of the Celgar mill. See "The Acquisition".

In addition, we own and operate two paper mills located at Heidenau and Fährbrücke, Germany, which produce specialty papers and printing and writing papers and, based upon their current product mix, have an aggregate annual production capacity of approximately 70,000 ADMTs.

The Pulp Industry

Pulp is used in the production of paper, tissues and paper related products. Pulp is generally classified according to the type of raw material, or fiber, and the process used in its production and the degree to which it is bleached. Kraft pulp can be made in different grades, with varying technical specifications, for different end uses. Kraft pulp can be bleached to increase its brightness. It is noted for its strength, brightness and absorption properties and is used to produce a variety of products, including lightweight publication grades of paper, tissues and paper related products.

The market value of kraft pulp depends in part on the fiber used in the production process. There are two primary species of wood used as fiber: softwood and hardwood. Softwood species have long, flexible fibers and add strength to paper. Hardwood species contain shorter fibers which lend bulk and opacity. Prices for softwood pulp are generally much higher than for hardwood pulp. As at September 30, 2004, there was an approximately \$110 per ADMT difference in their list prices in Europe. Currently, the kraft pulp market is roughly evenly split between softwood and hardwood grades. Most uses of market kraft pulp, including in the production of fine printing papers, coated and uncoated magazine papers and tissue grades, utilize a mix of softwood and hardwood grades to optimize production and product qualities. In recent years, production of hardwood pulp, based on fast growing plantation fiber primarily from Asia and South America, has increased much more rapidly than softwood grades that have longer growth cycles. As a result of the growth in supply and lower costs, many kraft pulp customers in recent years have substituted some of the pulp content in their products to hardwood pulp. Counteracting this trend has been the requirement for strength characteristics in finished goods, paper and tissue makers' focus on higher machine speeds, and an industry move towards lower basis weights for publishing papers, all of which require the strength characteristics of softwood pulp and, in particular, NBSK pulp. We believe that the ability of kraft pulp users to further substitute hardwood for softwood pulp is limited by such requirements.

NBSK pulp, which is a bleached kraft pulp manufactured using species of northern softwood fiber primarily in northern Europe and Canada, is considered a premium grade because of its strength. It generally obtains the highest price relative to other kraft pulps. NBSK pulp is the sole product of the Rosenthal, Stendal and Celgar mills.

Producers ranging from small independent manufacturers to large integrated companies produce pulp worldwide. In 2003, more than 130 million ADMTs of kraft pulp were converted into printing and writing papers, tissues, cartonboards and other white grades of paper and paperboard around the world. Approximately 65% of this pulp was produced for internal use by integrated paper and paperboard manufacturers, and approximately 35% was produced for sale on the open market as market pulp.

Although demand is cyclical, worldwide demand for kraft market pulp has grown at an average rate of approximately 3% annually over the last ten years. The historical growth rate in demand for NBSK pulp reflects similar trends. The following chart illustrates the worldwide NBSK market pulp demand for the specified periods:

Worldwide NBSK Market Pulp Demand

Source: Pulp and Paper Products Council

Western Europe accounts for approximately 40% of global market pulp demand with a growth rate of approximately 2% annually over the past ten years. Approximately 18 million ADMTs of market pulp were consumed in western Europe in 2003, of which approximately six million ADMTs were comprised of NBSK pulp. With its large economy and sizable paper industry, Germany is the largest pulp import market in Europe, consuming approximately six million ADMTs of market pulp in 2003, of which approximately 61% was kraft pulp, while relying largely on imports from North America and Scandinavia.

Demand for market pulp in Asia (excluding Japan) has been growing at approximately 9% annually over the past ten years and currently accounts for approximately 30% of global demand. Approximately 13 million ADMTs of market pulp were consumed in Asia (excluding Japan) in 2003, of which approximately 2.3 million ADMTs were comprised of NBSK pulp. Canada is the largest exporter to this region, supplying approximately three million ADMTs of market pulp in 2003, approximately two million ADMTs of which were comprised of NBSK pulp. Additionally, Japan consumed approximately three million ADMTs of market pulp in 2002, the latest year for which data is available, of which approximately 25% was comprised of NBSK pulp.

Global economic conditions, changes in production capacity, inventory levels, and currency exchange rates are the primary factors affecting NBSK pulp list prices. Canada and western Europe currently represent approximately 50% and 40%, respectively, of global NBSK pulp capacity while list prices are denominated in U.S. dollars. The following chart illustrates the average annual European NBSK list pulp prices since 1990:

Average Annual European NBSK List Pulp Prices

Source: Pulp and Paper Week

The average annual European list prices for NBSK pulp between 1990 and 2003 ranged from a low of \$444 per ADMT in 1993 to a high of \$875 per ADMT in 1995. Following a decline in demand in 2001, list prices for NBSK pulp also declined and averaged approximately \$463 per ADMT in 2002. An increase in demand resulting from improving American and major European economies and the weakening of the U.S. dollar against the Euro and other major currencies in 2003 resulted in list prices for kraft pulp in Europe increasing to approximately \$560 per ADMT in December 2003 despite relatively high inventory levels. List prices for kraft pulp in Europe continued to strengthen in 2004 due to the relatively weak U.S. dollar and improving world economies, with particularly strong growth in demand in Asia. List prices increased to approximately \$660 per ADMT in July 2004, before falling to approximately \$585 per ADMT in October 2004 and subsequently recovering to approximately \$625 per ADMT in December 2004. A producer's sales realizations reflect customer discounts, commissions and other items and it is likely that NBSK pulp prices will continue to fluctuate in the future.

Competitive Strengths

Our competitive strengths include the following:

Modern Low Cost NBSK Pulp Mills. Upon the acquisition of the Celgar mill and the ramp up of the Stendal mill, we will operate three large, modern, low cost NBSK pulp mills. The significant capital investments at the Rosenthal mill have resulted in a facility which ranks in the lowest cost quartile for NBSK pulp delivered to Europe. We expect our overall cost structure to

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improve because the Stendal mill is designed to have even lower production costs than the Rosenthal mill. Based on an industry survey, we believe that the Celgar mill ranks in the second quartile in North America on a manufactured cost basis for NBSK pulp. The relative age and production capacity of our NBSK pulp mills provide us with certain manufacturing cost advantages over many of our competitors including lower maintenance capital expenditures.

High Quality NBSK Pulp Products. Our pulp mills produce high quality NBSK pulp which is a premium grade of kraft pulp. Our Rosenthal mill continues to increase the proportion of its sales of reinforcement NBSK pulp, which is used to produce stronger papers and generally obtains the highest price. The Stendal mill is similarly expected to produce a very high quality NBSK pulp product, although from a slightly different species mix, resulting in a complementary product more suitable for different end uses. We believe that the pulp produced at the Celgar mill has excellent product characteristics.

Close Proximity to Customers. We are the sole kraft pulp producer and the only producer of market pulp in Germany, which is the largest pulp import market in Europe. Due to the proximity of the Rosenthal and Stendal mills to most of our European customers and the new member countries of the European Union, we benefit from lower transportation costs relative to our major competitors. As the Celgar mill is located in western Canada, it is well situated to serve Asian and North American customers. We believe our ability to deliver pulp on a timely basis enhances customer satisfaction and has made us a preferred supplier for many customers.

Stable and Abundant Fiber Supply. There is a significant amount of high-quality fiber within a close radius of each of our pulp mills. This fiber supply, combined with our purchasing power, provides us with an ability to enter into contracts which have relatively stable prices and volumes.

Strategy

Our corporate strategy is to create shareholder value by focusing on the expansion of our asset and earnings base through organic growth and acquisitions primarily in Europe and North America. We pursue organic growth through active management and targeted capital expenditures designed to produce a high return by increasing production, reducing costs and improving quality. We seek to acquire interests in companies and assets in the pulp and paper industry and related businesses where we can leverage our experience and expertise in adding value through a focused management approach. Key features of our strategy include:

Focusing on NBSK Market Pulp. We focus on NBSK pulp because it is a premium grade kraft pulp known for its strength and generally obtains the highest price relative to other kraft pulps. Although demand is cyclical, worldwide demand for kraft market pulp has grown at an average of approximately 3% per annum over the last ten years with higher growth rates in certain markets such as eastern Europe and Asia. We do not believe there are any significant new NBSK pulp production capacity increases coming online in the next several years due in part to fiber supply constraints and high capital costs.

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

Improving Efficiency and Reducing Operating Costs. We focus on increasing the productivity and operating efficiency of our production facilities through cost reduction initiatives, including targeted capital investments. We seek to make high return capital investments that increase the

production and operating efficiency at our production facilities, reduce costs and improve product quality. We also seek to reduce operating costs by better managing certain operating activities at our facilities such as fiber procurement, sales and marketing activities, and we intend to further coordinate these activities at our pulp facilities to realize on potential synergies among them. In particular, we believe there are a number of opportunities to reduce the operating costs, increase production and improve the financial results of the Celgar mill.

Enhancing Customer Relationships. We focus on continually improving our marketing and distribution capabilities to enhance our customer relationships and capitalize on our geographic diversification. We seek to differentiate ourselves from our competitors by consistently delivering high quality products to our customers on a global basis. We intend to coordinate the marketing and distribution activities at our pulp mills to better service our customers.

Acquisition of Celgar Pulp Mill

Overview

On November 22, 2004, we entered into an agreement to acquire substantially all of the assets of Stone Venepal (Celgar) Pulp Inc., referred to as "Celgar", for \$210 million, of which \$170 million is payable in cash and \$40 million is payable in our shares, plus an amount for the defined working capital at the Celgar mill on closing of the Acquisition. The purchase price is subject to certain adjustments and excludes fees and expenses. See "The Acquisition".

The Celgar mill is a modern NBSK pulp mill that produces high quality NBSK pulp. It has an annual production capacity of approximately 430,000 ADMTs, and is located near the city of Castlegar, British Columbia, Canada. Completely rebuilt in the 1990s through an C\$850 million modernization and expansion project, the Celgar mill was transformed into a low cost producer of high quality NBSK pulp. In 1998, primarily as a result of the indebtedness incurred by Celgar during the modernization process, its directors assigned it into bankruptcy and KPMG Inc. was appointed trustee in bankruptcy. Immediately thereafter, two senior secured bank lenders of Celgar, being Royal Bank of Canada and National Westminster Bank PLC, appointed KPMG Inc. as the receiver for all of the assets and undertakings of Celgar under their security. KPMG Inc. has operated the Celgar mill as trustee in bankruptcy since that time.

The Celgar mill has a secure supply of high quality wood chips and pulp logs that are purchased from a diverse group of Canadian and U.S. suppliers. The supply of fiber is characterized by a mix of a variety of species (whitewoods and cedar) which allows for production flexibility, custom blending and varied pulp grade mix.

We believe that the pulp produced at the Celgar mill has excellent product characteristics and the mill is a long-established supplier to paper producers in Asia. We also believe that Celgar's NBSK pulp is well recognized in China, having been sold there for over 20 years. The Asian markets show the highest rate of growth in demand for softwood pulp and, with the Celgar mill's history in the region, we believe that we will be well placed to exploit such growth.

The Acquisition is subject to various conditions, including, without limitation, our offering of senior notes under this prospectus supplement, the offering of our shares of beneficial interest and the establishment of new working capital facilities for the Celgar mill and Rosenthal mill and certain regulatory approvals.

Acquisition Rationale

The Acquisition of the Celgar mill reflects our strategy of acquiring world-class market NBSK pulp production capacity on terms below comparable replacement cost where we can use our management

focus to enhance operations, improve profitability and create value for our stakeholders. It provides us with several strategic benefits and synergies, including the following:

Enhancing Our Position as a Leading Market NBSK Pulp Producer. The Acquisition will make us one of the largest producers of market NBSK pulp in the world. We will have a consolidated annual production capacity of approximately 1.3 million ADMTs of high quality NBSK pulp from three modern NBSK pulp mills located in Europe and North America. We believe this will improve our service to those larger paper and tissue producing customers who wish to develop purchasing arrangements with pulp suppliers that can service them on a worldwide basis.

Creating Value Through Active Management. We believe we can leverage our management focus and turnaround experience to enhance the Celgar mill's operating performance by improving price realizations, increasing production and reducing production costs. See "The Acquisition Acquisition Opportunities".

Diversifying Our Revenue and Cost Base. In 2003, substantially all of Mercer's revenues resulted from sales in Europe. Approximately 69% of the Celgar mill's sales in 2003 were in Asia, which is the fastest growing market for NBSK pulp imports. The Celgar mill's costs are largely in Canadian dollars, which should reduce our relative exposure to the exchange rate between the U.S. dollar and Euro.

Given our management team's experience in converting and optimizing the Rosenthal mill, constructing the Stendal mill and starting up these large scale NBSK pulp mills, we believe we are well positioned to integrate the Celgar mill into our operations and to improve its operating and financial performance over time. We have identified teams of individuals in our organization, at the Celgar mill and from our consulting engineers that, upon the closing of the Acquisition, will initiate the process of integrating the Celgar mill and enhancing its operations.

Acquisition Opportunities

Although the Celgar mill is a modern facility that has generally been well maintained, it has been operated by a trustee in bankruptcy since 1998. As a result, we believe the Celgar mill has not performed at its full potential and that there are a number of opportunities to enhance its performance. Although we will not know the full potential until we control the Celgar mill, we are currently targeting C\$25 million in annual operating margin improvements over a three-year period, based on current pricing levels. This is expected to be achieved by capitalizing on the following opportunities:

Improving Price Realizations. We understand that, in 2003, the Celgar mill's pulp price realizations were approximately C\$38 per ADMT below the average for NBSK pulp mills in British Columbia, Canada. We believe this resulted from the mill's current sales arrangements which rely solely on third party agents, its product classification and a history of inconsistent production. We intend to have our existing sales force take over responsibility for supervising and managing agent sales and perform some of its sales functions directly on a coordinated global basis with our Rosenthal and Stendal mills over time. We also intend to reduce the amount of pulp sold at a discount in the spot market by adding to the number of grades of pulp marketed by the mill and more effectively matching it with customer requirements and improving the mill's pulp brightness consistency through a planned strategic capital project. We plan to eliminate the price realization discount incurred by the Celgar mill in comparison to other NBSK pulp mills in British Columbia, Canada, over time. See "The Acquisition Acquisition Opportunities".

Increasing Production. We, in conjunction with our consulting engineers, have identified certain high return capital projects that we believe can increase the production of the Celgar mill, along

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with lowering its operating costs and improving the mill's reliability. Through these identified strategic capital projects, along with other enhancements and debottlenecking initiatives, we plan to increase the Celgar mill's production capacity to approximately 470,000 ADMTs over time.

Lowering Production Costs. We believe that we can reduce the Celgar mill's production costs by improving its operating consistency and reliability. We plan to achieve these improvements through certain strategic capital projects, as well as revising the mill's approach to maintenance management through a greater focus on preventative maintenance, such as we conduct at our Rosenthal mill. We believe these initiatives will reduce costs, including chemical and energy costs, at the Celgar mill.

We estimate the aggregate amount to be spent on the foregoing capital projects to be approximately C\$25 million over a three-year period.

The Financings

In conjunction with the Acquisition, we are also offering shares of beneficial interest concurrently with this offering. We intend to offer approximately 9.4 million shares of beneficial interest for estimated net proceeds, before expenses, of approximately \$75.8 million, assuming no exercise of the over-allotment option. The net proceeds from this offering, the net proceeds from the concurrent offering of our shares of beneficial interest and cash on hand will be utilized to pay the cash portion of the purchase price of the Acquisition, the amount for the defined working capital of the Celgar mill on closing of the Acquisition, the transaction costs of the Acquisition and to refinance all of the bank indebtedness of our Rosenthal mill (€150.2 million or \$186.5 million as at September 30, 2004, net of restricted cash of €28.5 million or \$35.4 million). The offering of our shares of beneficial interest will be conducted as a separate public offering by means of a separate prospectus supplement. In this prospectus supplement, we refer to our offering of the senior notes as the "Senior Note Offering" and the offering of our shares of beneficial interest as the "Share Offering". The completion of the Senior Note Offering and the Share Offering are contingent upon each other. Both such offerings are contingent upon the satisfaction or waiver of all conditions relating to the Acquisition other than the condition relating to the financings.

Effective upon the completion of the Acquisition, we intend to establish a new revolving working capital facility for the Rosenthal mill in the amount of €40 million with an initial term of five years and for the Celgar mill in the amount of \$30 million with an initial term of one year which, if not renewed, will convert to a one year term loan. In this prospectus supplement, we refer to the Share Offering, the Senior Note Offering and the two new revolving working capital facilities as the "Financings". See "The Financings", "The Acquisition" and "Description of Certain Indebtedness - New Working Capital Facilities".

Corporate Structure

Substantially all of our operations are conducted through subsidiaries. Our operations at the Stendal mill are conducted through Stendal, our operations at the Rosenthal mill are conducted through Rosenthal, our operations at the Celgar mill will be conducted through a wholly owned subsidiary and our paper operations are conducted through our wholly owned subsidiary, Dresden. Stendal and Dresden will be designated as unrestricted subsidiaries under the indenture governing the notes. As a result, these subsidiaries, their assets, liabilities and results of operations will not be part of a restricted group subject to the restrictive covenants of the indenture. We have presented unaudited pro forma financial information of our restricted group in this prospectus supplement to show the effect of excluding the assets, liabilities and results of operations of the unrestricted subsidiaries from the restricted group.

Organizational Chart

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

(1) Certain wholly owned intermediate holding companies are not shown.

Corporate Information

Mercer is a business trust organized under the laws of the State of Washington in 1968. Under Washington law, shareholders of a business trust have the same limited liability as shareholders of a corporation. Our operations are located primarily in Germany and, following the Acquisition, western Canada. We maintain offices at 14900 Interurban Avenue South, Suite 282, Seattle, Washington, USA 98168, and the telephone number is (206) 674-4639. We also maintain an office at Suite 2840, P.O. Box 11576, 650 West Georgia Street, Vancouver, British Columbia, Canada V6B 4N8 and the telephone number is (604) 684-1099.

The Offering

Issuer	Mercer International Inc.
Securities Offered	\$310,000,000 aggregate principal amount of 9.25% senior unsecured notes due 2013.
Offering Price	100% of the principal amount of notes plus accrued interest, if any, from February 14, 2005.
Maturity	The notes will mature on February 15, 2013.
Interest Payment Date	Interest will be payable in arrears on February 15 and August 15 of each year the notes are outstanding, beginning on August 15, 2005.
Ranking	<p>The notes are our senior unsecured obligations. Accordingly, the notes will rank:</p> <p style="padding-left: 40px;">effectively junior in right of payment to all our existing and future secured indebtedness and all indebtedness and liabilities of our subsidiaries;</p> <p style="padding-left: 40px;">equal in right of payment with all of our existing and future unsecured senior indebtedness; and</p> <p style="padding-left: 40px;">senior in right of payment to our 8.5% Convertible Senior Subordinated Notes due 2010 and any future subordinated indebtedness.</p>
Optional Redemption	We may redeem the notes, in whole or in part, on or after February 15, 2009, at the applicable redemption prices described under "Description of the Notes - Optional Redemption", plus accrued and unpaid interest, if any, to the redemption date. In certain circumstances, we may also redeem up to 35% of the aggregate principal amount of the notes at any time prior to February 15, 2008 at a redemption price of 109.25% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date with the net cash proceeds of certain equity offerings. See "Description of the Notes - Optional Redemption".
Covenants of the Indenture	<p>We will issue the notes under an indenture which will, among other things, restrict our ability and the ability of our restricted subsidiaries to, among other things:</p> <p style="padding-left: 40px;">incur additional indebtedness or issue preferred stock;</p> <p style="padding-left: 40px;">pay dividends or make other distributions to our stockholders;</p> <p style="padding-left: 40px;">purchase or redeem capital stock or subordinated indebtedness;</p> <p style="padding-left: 40px;">make investments;</p> <p style="padding-left: 40px;">create liens and enter into sale and leaseback transactions;</p> <p style="padding-left: 40px;">incur restrictions on the ability of our restricted subsidiaries to pay dividends or make other payments to us;</p> <p style="padding-left: 40px;">sell assets;</p>

consolidate or merge with or into other companies or transfer all or substantially all of our assets; and

engage in transactions with affiliates.

These limitations will be subject to a number of important qualifications and exceptions. See "Description of the Notes – Covenants".

Change in control

Upon certain changes in control, each holder of the notes may require us to repurchase some or all of its notes 30 business days after the occurrence of the change in control at a purchase price equal to the principal amount of the notes plus accrued and unpaid interest, if any, to the date of purchase. See "Description of the Notes – Purchase of Notes at the Option of Holders Upon a Change in Control".

Form of the notes

The notes will be issued in book-entry form and will be represented by one or more global securities deposited with a custodian for and registered in the name of a nominee of The Depository Trust Company, or "DTC".

Use of Proceeds

We estimate the net proceeds from the offering of senior notes, after deducting fees and expenses, to be approximately \$300.5 million. In conjunction with the Acquisition, we are also offering approximately 9.4 million shares of beneficial interest for estimated net proceeds, before expenses, of approximately \$75.8 million (approximately \$87.2 million if the underwriters exercise their over-allotment option in full). The net proceeds from this offering, the net proceeds from the concurrent Share Offering and cash on hand will be utilized to pay the cash portion of the purchase price of the Acquisition, the amount for the defined working capital at the Celgar mill on closing of the Acquisition, the transaction costs of the Acquisition and to refinance all of the net bank indebtedness of our Rosenthal pulp mill.

A portion of the proceeds from the Acquisition will be disbursed by KPMG Inc. to Royal Bank of Canada on account of its prior existing senior secured loans to Celgar. Royal Bank of Canada is the indirect parent of RBC Capital Markets Corporation, one of the underwriters of this offering.

See "Use of Proceeds", "The Financings", "Description of the Notes" and "Description of Certain Indebtedness – New Working Capital Facilities" for more information.

Risk Factors

See "Risk Factors" and other information included or incorporated by reference in this prospectus supplement for a discussion of factors you should consider carefully before deciding to invest in the senior notes offered under this prospectus supplement.

Summary Historical Consolidated Financial Data

The following tables set forth Mercer's summary historical consolidated financial data and certain operating data relating to Celgar as at and for the periods indicated. The following summary historical consolidated financial data should be read in conjunction with the financial statements and the related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" of both Mercer and Celgar included elsewhere in this prospectus supplement. The operating data relating to Celgar reflects its operations prior to the Acquisition when Celgar was operating under management of a trustee in bankruptcy under Canadian bankruptcy law.

The summary historical financial data for Mercer as at and for the four years ended December 31, 2003 presented below is derived from Mercer's audited consolidated financial statements. The summary historical financial data for Mercer as at and for the nine months ended September 30, 2003 and 2004 presented below is derived from Mercer's unaudited consolidated financial statements and includes, in the opinion of our management, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly this unaudited interim financial data. The results for any interim period are not necessarily indicative of the results for an entire fiscal year.

Effective January 1, 2002, we changed our reporting currency from the U.S. dollar to the Euro. The following summary historical financial data relating to Mercer for the periods prior to the year ended December 31, 2002 has been restated in Euros and reclassified to conform with the current year's presentation.

Year Ended December 31,				Nine Months Ended September 30,	
2000	2001 ⁽¹⁾	2002 ⁽¹⁾	2003	2003	2004

(unaudited)

(in thousands, except for ratios)

Statement of Operations Data:

Revenues	€ 258,883	€ 216,447	€ 239,132	€ 194,556	€ 144,136	€ 153,868
Cost of sales	193,704	184,679	213,463	179,690	134,226	133,642
Gross profit	65,179	31,768	25,669	14,866	9,910	20,226
Income (loss) from operations	49,665	13,332	(1,145)	(4,541)	(2,519)	(7,625)
Interest expense	15,198	16,170	13,753	11,523	6,887	9,554
Income (loss) before income taxes and minority interest	32,130	(2,740)	(17,551)	(6,068)	(17,446)	(16,577)
Income (loss) before minority interest	32,013	(2,823)	(17,287)	(9,240)	(17,672)	(16,540)
Minority interest			10,965	5,647	8,499	3,936
Net income (loss)	32,013	(2,823)	(6,322)	(3,593)	(9,173)	(12,604)

Other Data:

Net cash from (used in) operating activities	€ 43,395	€ 30,364	€ 40,446	€ 31,440	€ 6,969	€ (1,185)
Depreciation and amortization ⁽²⁾	€ 24,046	€ 22,966	€ 25,614	€ 24,105	€ 18,135	€ 17,217
Capital expenditures ⁽³⁾	€ 27,028	€ 10,097	€ 13,800	€ 14,647	€ 9,485	€ 6,611
Operating EBITDA ⁽⁴⁾	€ 73,711	€ 36,298	€ 24,469	€ 19,564	€ 15,616	€ 15,592
Ratio of earnings to fixed charges ⁽⁵⁾	3.11	0.83 ⁽⁶⁾	⁽⁶⁾	0.32 ⁽⁶⁾	⁽⁶⁾	⁽⁶⁾

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As at December 31,

	2000	2001	2002	2003	As at September 30, 2004
					(unaudited)

(in thousands)

Balance Sheet Data:

Cash and cash equivalents	€ 19,689	€ 11,741	€ 30,261	€ 51,993	€ 42,643
Restricted cash	26,775	33,388	48,254	59,367 ⁽⁷⁾	76,884 ⁽⁷⁾
Working capital (deficit)	28,388	15,544	6,328	(48,947) ⁽⁸⁾	(122,474) ⁽⁸⁾
Total assets	429,724	429,593	599,750	935,905 ⁽⁹⁾	1,192,727
Debt, current portion, and note payable	29,822	25,752	17,138	17,178	16,868
Note payable, construction in progress ⁽¹⁰⁾			15,000		
Debt, Stendal, current portion				80,000	50,000
Debt, less current portion ⁽¹¹⁾	221,772	216,871	205,393	255,901	234,317
Debt, Stendal, ⁽¹⁰⁾ less current portion			146,485	324,238	476,301
Shareholders' equity	133,497	131,613	124,969	132,855	121,595

Year Ended December 31,

Nine Months Ended
September 30,

	2000	2001	2002	2003	2003	2004
						(unaudited)

(in thousands, except for ADMT data)

Rosenthal Mill Operating Data⁽¹²⁾:

Sales volume (ADMTs) ⁽¹³⁾	239,552	285,654	293,607	303,655	221,926	229,462
Productivity (ADMTs produced per day)	736	858	887	898	893	914
Average price realized (per ADMT) ⁽¹³⁾	€ 667	€ 512	€ 443	€ 417	€ 416	€ 452
Cash production costs (per ADMT produced) ⁽¹⁴⁾	€ 353	€ 342	€ 312	€ 307	€ 310	€ 300
Income (loss) from operations	€ 49,594	€ 18,610	€ 3,421	€ 1,931	€ (22)	€ 13,004
Depreciation and amortization ⁽⁷⁾	€ 20,481	€ 21,422	€ 21,567	€ 21,881	€ 16,311	€ 14,166
Capital expenditures	€ 23,766	€ 7,416	€ 8,426	€ 6,869	€ 3,459	€ 2,924

Celgar Mill Operating Data:

(unaudited)

Sales volume (ADMTs)	379,375	365,132 ⁽¹⁵⁾	400,101	427,860	329,253	292,233
Productivity (ADMTs produced per day)	1,172	1,198 ⁽¹⁵⁾	1,155	1,202	1,181	1,209
Average price realized (per ADMT)	C\$ 958	C\$ 674 ⁽¹⁵⁾	C\$ 623	C\$ 635	C\$ 630	C\$ 735
Cash production costs (per ADMT produced) ⁽¹⁴⁾	C\$ 565	C\$ 571 ⁽¹⁵⁾	C\$ 491	C\$ 499	C\$ 513	C\$ 533
Income (loss) from operations ⁽¹⁶⁾	C\$ 64,224	C\$ (58,642) ⁽¹⁵⁾	C\$ (33,810)	C\$ (36,283)	C\$ (32,850)	C\$ (127,572) ⁽¹⁷⁾
Depreciation and amortization	C\$ 38,807	C\$ 38,966	C\$ 38,932	C\$ 39,225	C\$ 29,320	C\$ 22,833
Capital expenditures	C\$ 3,579	C\$ 6,262	C\$ 3,912	C\$ 5,201	C\$ 3,985	C\$ 2,017

- (1) In December 2001, we acquired Landqart AG, or "Landqart", which operates a specialty paper mill, for approximately \$2.7 million. Results from the Landqart mill are not included in Mercer's results for 2001, but are included for 2002. The Landqart mill sold approximately 18,222 ADMTs for €39.7 million in the year ended December 31, 2002. At the end of 2002, we transferred 20% of our interest in Landqart to a Swiss bank and exchanged our remaining 80% interest for an indirect 39% minority interest through a limited partnership on a non-cash basis. As of December 31, 2002, our interest in the Landqart mill is no longer consolidated and is included in our financial results on an equity basis.
- (2) The Stendal pulp mill was substantially complete and ready for its intended use on September 18, 2004. Effective September 18, 2004, we began expensing all of the costs, including interest, related to the Stendal

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mill and began depreciating it. A depreciation period of 25 years was established based on the expected useful life of the production assets. Depreciation was computed using the straight-line method in accordance with our accounting policies. In conjunction with establishing the depreciation period for the Stendal mill, we also reviewed the useful life of the Rosenthal mill, which resulted in a change in the estimate of its useful life from an initial 15 to 25 years. The change in estimate was reflected effective July 1, 2004. As the Rosenthal mill had been depreciated for approximately 5 years as of July 1, 2004, the change in estimate reflects a remaining depreciable life of approximately 20 years. The total effect of the change in estimate resulted in a decrease of approximately €2.2 million in depreciation, cost of sales and net loss, and a decrease in basic and diluted net loss per share of €0.13 for the nine months ended September 30, 2004.

(3) Excluding capital expenditures of approximately €186.9 million, €399.4 million, €284.1 million and €235.1 million during the years ended December 31, 2002 and 2003 and the nine months ended September 30, 2003 and 2004, respectively, relating to the Stendal project.

(4) Net income (loss) to Operating EBITDA Reconciliation:

	Year Ended December 31,				Nine Months Ended September 30,	
	2000	2001	2002	2003	2003	2004
	(unaudited)					
	(in thousands)					
Net income (loss)	€ 32,013	€ (2,823)	€ (6,322)	€ (3,593)	€ (9,173)	€ (12,604)
Minority interest			(10,965)	(5,647)	(8,499)	(3,936)
Income taxes	117	83	(264)	3,172	226	(37)
Interest expense	15,198	16,170	13,753	11,523	6,887	9,554
Investment income	2,337	(2,872)	(436)	(1,653)	(1,055)	(1,679)
Derivative financial instruments		2,504	6,679	(16,168)	3,604	1,077
Impairment of investments				7,825	5,511	
Other		270	(3,590)		(20)	
	49,665	13,332	(1,145)	(4,541)	(2,519)	(7,625)
Income (loss) from operations						
Add: Depreciation and amortization	24,046	22,966	25,614	24,105	18,135	17,217
Impairment charge						6,000
Operating EBITDA	€ 73,711	€ 36,298	€ 24,469	€ 19,564	€ 15,616	€ 15,592

In connection with Mercer's results for the third quarter of 2004, our management determined to record and our audit committee approved a non-cash impairment charge of €6.0 million to write-off the carrying value of our Fährbrücke paper mill assets. We determined to take the impairment charge as the Fährbrücke mill has generated weaker than expected returns over a period of time despite changes to its product mix. We do not expect the impairment charge in and of itself to result in future cash expenditures as we intend to continue to operate the Fährbrücke mill.

We define Operating EBITDA for this purpose as income from operations plus depreciation and amortization and non-recurring capital asset impairment charges. Management uses Operating EBITDA as a benchmark measurement of its own operating results and as a benchmark relative to its competitors. Management considers it to be a meaningful supplement to operating and net income as a performance measure primarily because depreciation expense is not an actual cash cost and varies widely from company to company

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in a manner that management considers largely independent of the underlying cost efficiency of their operating facilities. In addition, we believe it 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. Management also believes Operating EBITDA facilitates operating performance comparisons from period to period by backing out the significant impact caused by our derivative instruments which are marked to market for each reporting period or settled. Operating EBITDA is not a measure of financial performance under accounting principles generally accepted in the United States, or "GAAP", and should not be considered as an alternative to net income (loss) or income from operations as a measure of performance, nor as an alternative

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to net cash from operating activities as a measure of liquidity. Operating EBITDA has significant limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our results as reported under GAAP. See "Management's Discussion and Analysis of Financial Condition and Results of Operations of Mercer Results of Operations" for a discussion of these limitations. Because of these limitations, Operating EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business. See the Statements of Cash Flows included in our consolidated financial statements included elsewhere in this prospectus supplement. Because all companies do not calculate Operating EBITDA in the same manner, Operating EBITDA as calculated by us may differ from Operating EBITDA as calculated by other companies.

- (5) For purposes of computing the ratio of earnings to fixed charges, earnings consist of income before income taxes, minority interest, income (loss) from equity investee and fixed charges. Fixed charges consist of interest expense plus capitalized interest.
- (6) For the years ended December 31, 2001, 2002 and 2003, our deficiency of earnings to fixed charges was €2.7 million, €20.7 million, €19.5 million, respectively. For the nine months ended September 30, 2003 and 2004, our deficiency of earnings to fixed charges was €29.0 million and €43.2 million, respectively.
- (7) As at December 31, 2003, this amount is comprised of €15.2 million for payment of construction in progress costs payable and €19.1 million in a debt service account, relating to construction in progress at the site of the Stendal mill, as well as €25.1 million in a debt service account relating to the Rosenthal mill. As at September 30, 2004, this amount is comprised of €29.3 million for payment of construction costs payable and €19.1 million in a debt service account, both relating to the Stendal project, as well as €28.5 million in a debt service account related to the Rosenthal mill.
- (8) We had a working capital deficit of €48.9 million and €122.5 million at December 31, 2003 and September 30, 2004, respectively, primarily because we had Stendal construction costs payable of €42.8 million and €161.0 million at December 31, 2003 and September 30, 2004, respectively, for which we had not yet drawn down under the Stendal project finance facility and, under our accounting policies, we do not record certain government grants until they are received. The Stendal construction costs will be paid pursuant to the Stendal project finance facility in the ordinary course. At September 30, 2004, we qualified for additional investment grants related to the Stendal mill totaling approximately €65.2 million from the federal and state governments of Germany, which we expect to receive in 2005. Approximately €61.2 million of these grants, when received, will be applied to repay the amounts drawn under the dedicated tranche of the Stendal project finance facility. The grants are not reported in our income and reduce the cost basis of the assets purchased when they are received. We expect to qualify for additional investment grants totaling €23.3 million when such Stendal construction costs have been substantially paid.
- (9) Includes approximately €503.2 million related to properties construction in progress at the site of the Stendal mill as at December 31, 2003.
- (10) Construction of the Stendal mill commenced in August 2002 and was completed substantially on its planned schedule and budget in the third quarter of 2004. As a result, as at September 30, 2004, liabilities relating to the construction of the Stendal mill were no longer classified as construction in progress.
- (11) As at September 30, 2004, this includes €66.4 million aggregate principal amount of 8.5% convertible senior subordinated notes due October 2010, convertible at any time by the holder into our shares of beneficial interest at \$7.75 per share.
- (12) Construction of the Stendal Mill was completed in the third quarter of 2004. Although the Stendal mill had approximately 13 days of operations in September 2004, it is currently in the start-up phase. As a result, management believes that the operating data relating to the Stendal mill during the third quarter of 2004 would not provide an accurate representation of the mill's actual operating performance in the future. Accordingly, we have provided only the operating data relating to the Rosenthal mill.
- (13) For external sales only.

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- (14) Cost of production per ADMT produced excluding depreciation. Total cash production costs for the nine months ended September 30, 2003 and 2004 may not be comparable on an annualized basis due to the timing of maintenance expenditures.
- (15) The Celgar mill was shut down for approximately 50 days in 2001 for market related reasons.
- (16) Income (loss) from operations includes costs (benefits) relating to a burner misalignment in the lime kiln at the Celgar mill, for which the vendor of the Celgar mill has an insurance claim outstanding, foreign exchange losses (gains) on current receivables and payables and fees paid to KPMG Inc., as receiver and trustee in bankruptcy of Celgar as follows:

	Year Ended December 31,				Nine Months Ended September 30,	
	2000	2001	2002	2003	2003	2004
	(unaudited)				(unaudited)	
	(in thousands)					
Lime kiln costs	C\$	C\$	C\$	C\$ 3,136	C\$ 2,036	C\$ 96
Foreign exchange losses (gains)	C\$	(1,333)	C\$ (1,769)	C\$ 792	C\$ 5,965	C\$ 4,952
Receiver and trustee costs	C\$	1,965	C\$ 2,025	C\$ 1,812	C\$ 1,899	C\$ 1,747
				C\$ 1,899	C\$ 1,747	C\$ 772

See "Management's Discussion and Analysis of Financial Condition and Results of Operations of Celgar".

- (17) As at and for the nine month period ended September 30, 2004, Celgar recorded an impairment charge of C\$129.2 million to write-down the carrying value of its property, plant and equipment to the fair value of the assets as a result of the Acquisition.

Summary Unaudited Pro Forma Consolidated Financial Data

The following tables set forth Mercer's summary pro forma consolidated financial data as at and for the periods indicated and is derived from the unaudited pro forma consolidated financial statements included elsewhere in this prospectus supplement. The unaudited pro forma consolidated financial data has been prepared by us and gives pro forma effect to the Financings, the Acquisition, related transactions and the payment of estimated fees and expenses as if they had occurred on September 30, 2004 for the pro forma consolidated balance sheet as at September 30, 2004 and at the beginning of the period for the pro forma consolidated statement of operations for the nine months ended September 30, 2003 and 2004 and the year ended December 31, 2003. The unaudited pro forma restricted group financial data presented below represents the unaudited financial results and condition of the restricted group, which is comprised of Mercer Inc., Rosenthal and our acquisition subsidiary which is acquiring the Celgar mill that will be designated restricted subsidiaries under the indenture governing the notes. Stendal and Dresden and their subsidiaries will be designated unrestricted subsidiaries under the indenture and will not be subject to the restrictive covenants of the indenture. This unaudited pro forma restricted group financial data excludes the effect of consolidation of the ownership and operation of the unrestricted subsidiaries. The unaudited pro forma balance sheet data of the restricted group includes the pro forma effect of the Financings, the Acquisition, related transactions and the payment of estimated fees and expenses and excludes the effect of consolidation of the ownership of the unrestricted subsidiaries. The unaudited pro forma statements of operations data of the restricted group gives effect to the Financings, the Acquisition, related transactions and the payment of estimated fees and expenses as if they occurred at the beginning of each period presented and eliminates the results of operations of the unrestricted subsidiaries that are not included in the consolidated restricted group. Shareholders' equity of the restricted group reflects the net assets of the restricted group.

We have included this pro forma restricted group financial data because we believe it provides investors with helpful information with respect to the financial results of the business and operations that will be subject to restrictive covenants in the indenture governing the notes. The following summary unaudited pro forma consolidated financial data should be read in conjunction with our consolidated financial statements and the related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" of both Mercer and Celgar and the unaudited pro forma consolidated financial statements and the related notes included elsewhere in this prospectus supplement. The pro forma information is presented for illustrative purposes only and does not purport to represent what our actual results of operations or financial position would have been had the matters described above occurred on the date assumed, nor is it necessarily indicative of our future operating results or financial position.

	Pro Forma		Pro Forma Restricted Group	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	Year Ended Dec. 31, 2003	2003	Year Ended Dec. 31, 2003	2003

(unaudited)

(unaudited)

(in thousands)

Statement of Operations Data:

Revenues	€ 365,725	€ 274,681	€ 285,904	€ 310,721	€ 233,390	€ 245,939
Cost of sales	336,921	258,178	245,579	286,521	221,231	204,876
Gross profit	28,804	16,503	40,325	24,200	12,159	41,063
General and administrative	41,833	29,472	34,584	33,024	23,999	23,979
Settlement expenses	1,041	630		1,041	630	
Impairment of capital assets			6,000			
Flooding grants less losses and expenses	957	1,162	(669)			
Income (loss) from operations	(13,113)	(12,437)	(928)	(9,865)	(12,470)	17,084
Interest expense	26,126	18,118	20,901	29,297	21,781	22,521
Investment income	993	542	556	3,704	3,666	1,881
Derivative financial instruments gains (losses)	15,048	(22,306)	491	27,347	(367)	1,293
Impairment of equity method investments	2,255			2,255		
Impairment of available-for-sale securities	5,570	5,511		4,480	4,441	
Foreign exchange gain on term credit facility	14,571	11,654	1,791	14,571	11,654	1,791
Loss before income taxes and minority interest	(16,452)	(46,176)	(18,991)	(275)	(23,739)	(472)
Loss before minority interest	(19,624)	(46,402)	(18,954)	(3,447)	(23,965)	(435)
Minority interest	5,647	8,499	3,936			
Net loss	(13,977)	(37,903)	(15,018)	(3,447)	(23,965)	(435)

Pro Forma

Pro Forma Restricted Group

As at
September 30, 2004As at
September 30, 2004

(unaudited)

(unaudited)

(in thousands)

Balance Sheet Data:

Cash and cash equivalents	€ 41,310	€ 35,351
Restricted cash	48,420	
Working capital (deficit) ⁽¹⁾	(89,163)	62,870
Total assets	1,369,349	548,964
Debt, current portion, and note payable	1,779	
Debt, Stendal, current portion	50,000	
Debt, less current portion ⁽²⁾⁽³⁾	320,373	316,099
Debt, Stendal, less current portion ⁽⁴⁾	476,301	
Shareholders' equity	214,883	192,590

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Pro Forma			Pro Forma Restricted Group		
Year Ended Dec. 31, 2003	Nine Months Ended September 30,		Year Ended Dec. 31, 2003	Nine Months Ended September 30,	
	2003	2004		2003	2004
	(unaudited)			(unaudited)	
(in thousands, except for ratios)					

Other Data:

Operating EBITDA ⁽⁵⁾	€	22,903	€	14,631	€	31,222	€	24,120	€	12,799	€	40,671
Indenture EBITDA ⁽⁶⁾		N/A		N/A		N/A	€	32,975	€	19,457	€	43,942
Ratio of earnings to fixed charges ⁽⁷⁾		0.31 ⁽⁸⁾		⁽⁸⁾		0.05 ⁽⁸⁾		N/A		N/A		N/A

- (1) We had a working capital deficit of €122.5 million at September 30, 2004, primarily because we had Stendal construction costs payable of €161.0 million at September 30, 2004 for which we had not yet drawn down under the Stendal project finance facility and, under our accounting policies, we do not record certain government grants until they are received. The Stendal construction costs will be paid pursuant to the Stendal project finance facility in the ordinary course. At September 30, 2004, we qualified for additional investment grants related to the Stendal mill totaling approximately €65.2 million from the federal and state governments of Germany, which we expect to receive in 2005. Approximately €61.2 million of these grants, when received, will be applied to repay the amounts drawn under the dedicated tranche of the Stendal project finance facility. The grants are not reported in our income and reduce the cost basis of the assets purchased when they are received. We expect to qualify for additional investment grants totaling €23.3 million when such Stendal construction costs have been substantially paid.
- (2) As at September 30, 2004, this includes €66.4 million aggregate principal amount of 8.5% convertible senior subordinated notes due October 2010, convertible at any time by the holder into our shares of beneficial interest at \$7.75 per share.
- (3) In addition, Mercer Inc., a member of the restricted group, has guaranteed five credit facilities, aggregating approximately €4.7 million, relating to the paper operations which are operated by an unrestricted subsidiary.
- (4) Construction of the Stendal mill commenced in August 2002 and was completed substantially on its planned schedule and budget in the third quarter of 2004. As a result, as at September 30, 2004, liabilities relating to the construction of the Stendal mill were no longer classified as construction in progress.

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operating activities as a measure of liquidity. Operating EBITDA has significant limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our results as reported under GAAP. Because of these limitations, Operating EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business. See the Statements of Cash Flows included in our consolidated financial statements included elsewhere in this prospectus supplement. Because all companies do not calculate Operating EBITDA in the same manner, Operating EBITDA as calculated by us may differ from Operating EBITDA as calculated by other companies.

(6)

The indenture governing the notes will contain various restrictive covenants, including several that are based on a formulation of the financial measure EBITDA, which is net income (loss) adjusted to exclude interest, taxes, depreciation and amortization, certain non-cash charges and extraordinary or otherwise unusual gains or

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losses, and certain other items. We refer to this formulation of EBITDA as "Indenture EBITDA" which is defined in the note indenture as Consolidated EBITDA. The indenture governing the notes will provide that, in order to enter into certain types of transactions, including the incurrence of additional indebtedness, the making of restricted payments and the completion of mergers and consolidations, we must meet a minimum Indenture EBITDA to Fixed Charges ratio, referred to and defined as the Fixed Charge Coverage Ratio in the note indenture. See "Description of the Notes". Indenture EBITDA is included in this prospectus supplement to provide additional information with respect to our ability to incur debt and make distributions.

While Indenture EBITDA and similar variations thereof are frequently used as a financial measure of ability to incur debt or make distributions, these terms are not necessarily comparable to other similarly titled financial measures of other companies due to the potential inconsistencies in the method of calculation. Indenture EBITDA is not a financial measure that is prescribed by GAAP. As such, we encourage investors not to use Indenture EBITDA as a substitute for net income, operating cash flow or other similar GAAP financial measures of operating performance or cash flow, and to use them primarily for purposes of determining covenant compliance described above.

The following table sets forth the applicable components of Indenture EBITDA for the pro forma restricted group and also serves as a reconciliation to net income (loss) on a GAAP basis for the periods indicated:

	Pro Forma Restricted Group		
	Year Ended Dec. 31, 2003	Nine Months Ended September 30,	
		2003	2004
	(unaudited) (in thousands)		
Net loss, GAAP	€ (3,447)	€ (23,965)	€ (435)
Foreign exchange gain on indebtedness	(14,571)	(11,654)	(1,791)
Marked to market gain (loss) on hedging obligations	(27,347)	367	(1,293)
	(45,365)	(35,252)	(3,519)
Equity losses	1,676	912	554
	(43,689)	(34,340)	(2,965)
Income taxes	3,172	226	(37)
Interest expense	29,297	21,781	22,521
Depreciation and amortization	33,985	25,269	23,587
Impairment of investments	6,735	4,441	
Mercer stock compensation expense ^(a)	454	432	690
Mercer special shareholder costs ^(b)	601	212	
Acquisition expenses			58
Mercer corporate reorganization costs ^(c)	251		567
Celgar foreign exchange losses ^(d)	3,769	3,119	566
Celgar lime kiln costs ^(e)	1,982	1,283	59
Accrued interest income	(3,582)	(2,966)	(1,104)
	€ 32,975	€ 19,457	€ 43,942

(a) Mercer stock compensation expense is a non-cash expense related to stock options issued to trustees and officers.

(b) Mercer special shareholder costs are related to a proxy contest which occurred in connection with our annual meeting of shareholders held on August 22, 2003 resulting in additional proxy solicitation, settlement and related costs.

- (c) Mercer corporate reorganization costs are related to an internal corporate reorganization effected by Mercer within its German subsidiaries.

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- (d) Celgar foreign exchange losses are related to foreign exchange losses on current receivables and payables resulting from currency fluctuations.
- (e) Celgar lime kiln costs are additional incremental costs related to a burner misalignment at the Celgar lime kiln.
- Fixed charges, as defined in the note indenture, for the pro forma restricted group were comprised only of interest expense for the year ended December 31, 2003 and for the nine months ended September 30, 2003 and 2004. For the four quarters ending September 30, 2004, we calculate the Fixed Charge Coverage Ratio for the pro forma restricted group to be 1.9.
- (7) For purposes of computing the ratio of earnings to fixed charges, earnings consist of income before income taxes, minority interest, income (loss) from equity investee and fixed charges. Fixed charges consist of interest expense plus capitalized interest.
- (8) On a pro forma basis for the year ended December 31, 2003, and nine months ended September 30, 2003 and 2004, the deficiency of earnings to fixed charges was €29.9 million, €57.8 million and €45.7 million.

RISK FACTORS

You should carefully consider the risks described below and the other information in this prospectus supplement or incorporated by reference into this prospectus supplement before deciding whether to invest in the notes offered under this prospectus supplement. The risks described below are not the only ones facing our Company. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations.

Our business, financial condition, results of operations and cash flow, could be materially adversely affected by any of these risks. The trading price of the notes could decline due to any of these risks, and you may lose all or part of your investment.

This prospectus supplement also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below, set out under "Risks Related to our Company" in the accompanying prospectus and incorporated by reference into this prospectus supplement.

Risks Related to the Acquisition

Any failure to successfully integrate the Celgar mill with our business may adversely affect our results of operations.

Our future performance will depend in part on whether we can integrate the Celgar mill with our operations in an effective and efficient manner. The acquisition of the Celgar mill is larger than any of the other acquisitions we have made. Integrating the Celgar mill with our operations will be a complex, time consuming and potentially expensive process and will be subject to various risks including:

diversion of management's attention from our ongoing business;

the expense of upgrading the Celgar mill to enhance its operations may be more significant than currently anticipated;

difficulty integrating the operations, including financial and accounting functions, sales and marketing procedures, technology and other corporate administrative functions of the combined operations;

difficulty in establishing financial controls and procedures consistent with our own;

difficulty in converting the Celgar mill's current business information systems to our system;

difficulty maintaining relationships with present and potential customers, distributors and suppliers of the Celgar mill due to uncertainties regarding service, production quality and prices; and

problems retaining key employees who were previously employed by Celgar.

All of the pulp produced by the Celgar mill is currently sold by third party agents. We intend to perform some of its sales functions directly over time. We cannot assure you that our internal sales staff and third party agents will be able to sell the combined pulp production of the Rosenthal, Stendal and Celgar mills on terms as favorable as those achieved by the existing agents.

We estimate that we will incur costs of approximately €13.7 million associated with the Acquisition, the Financings, the related transactions and the estimated fees and expenses. A portion of these costs will be associated with the integration of the Celgar mill with our operations. The actual costs may substantially exceed our estimates and unanticipated expenses associated with such integration may arise. Furthermore, we may not be aware of all of the risks associated with the Acquisition and we may

not have identified adverse information concerning the assets we are acquiring. If the benefits of the Acquisition do not exceed the costs, our financial results will be adversely affected.

We cannot guarantee that we will successfully integrate the Celgar mill with our operations. If we are unable to address any of these risks, our results of operations and financial condition could be materially adversely affected and the operations of the Celgar mill may not achieve the results or otherwise perform as expected.

The operations of the Celgar mill are subject to their own risks, which we may not be able to manage successfully.

The financial results of the Celgar mill are subject to many of the same factors that affect our financial condition and results of operations, including the cyclical nature of the pulp and paper business, exposure to interest rate and currency exchange rate fluctuations, exposure to liability for environmental damage, the competitive nature of our markets and regulatory, legislative and judicial developments. The financial results of the Celgar mill could be materially adversely affected as a result of any of these or other related factors, which could have a material adverse effect on our results of operations and financial condition on a consolidated basis. See " Risks Related to our Company".

We have only limited recourse under the acquisition agreement for losses relating to the Acquisition.

The diligence conducted in connection with the Acquisition and the indemnification provided in the acquisition agreement may not be sufficient to protect us from, or compensate us for, all losses resulting from the Acquisition. Subject to certain exceptions, under the terms of the acquisition agreement, the maximum amount we may claim is limited to \$30 million (\$20 million in the case of environmental losses). Subject to certain exceptions, the vendor is only liable for misrepresentations or breaches of warranty for 15 months from the closing date of the Acquisition (12 months in the case of environmental losses). A material loss associated with the Acquisition for which there is no adequate remedy under the acquisition agreement that becomes known 15 months after the Acquisition (12 months in the case of environmental losses) could materially adversely affect our results of operations and financial condition and reduce the anticipated benefits of the Acquisition.

We may not be able to enhance the operating performance and financial results or lower the costs of the Celgar mill as planned.

While we believe that there are a number of opportunities to reduce operating costs, increase production and improve the financial results of the Celgar mill, we cannot fully evaluate the feasibility of our plans until we control the Celgar mill. We may not be able to achieve our planned operating improvements, cost reductions, capacity increases or improved price realizations in our expected time periods, if at all. In addition, some of the improvements that we hope to achieve depend upon capital expenditure projects that we plan to implement at the Celgar mill. Such capital projects may not be completed in our expected time periods, if at all, may not achieve the results that we have estimated or may have a cost substantially in excess of our planned amounts.

Risks Related to our Company

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

As of September 30, 2004, after giving effect to the Acquisition and the application of the proceeds from the Financings, we would have had approximately €848.5 million of indebtedness outstanding, of which €526.3 million is project debt of Stendal. We may also incur additional indebtedness in the future. Our high debt levels may have important consequences for us, including, but not limited to the following:

our ability to obtain additional financing to fund future operations or meet our working capital needs or any such financing may not be available on terms favorable to us or at all;

a certain amount of our operating cash flow is dedicated to the payment of principal and interest on our indebtedness, thereby diminishing funds that would otherwise be available for our operations and for other purposes;

a substantial decrease in net operating cash flows or increase in our expenses could make it more difficult for us to meet our debt service requirements, which could force us to modify our operations; and

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

Our ability to repay or refinance our indebtedness will depend on our future financial and operating performance. Our performance, in turn, will be subject to prevailing economic and competitive conditions, as well as financial, business, legislative, regulatory, industry and other factors, many of which are beyond our control. Our ability to meet our future debt service and other obligations may depend in significant part on the success of the Stendal and Celgar mills and the extent to which we can implement successfully our business and growth strategy. We cannot assure you that the Stendal or Celgar mill will be successful or that we will be able to implement our strategy fully or that the anticipated results of our strategy will be realized.

Our Stendal mill is subject to risks commonly associated with the start-up of large greenfield industrial projects.

We are the majority shareholder of a project company that has recently completed construction of the Stendal NBSK pulp mill near the town of Stendal, Germany. The aggregate cost of the mill is approximately €1.0 billion. The performance of the Stendal mill will have a material impact on our financial condition and operating performance. The implementation of the Stendal project commenced in 2002 and construction was completed in the third quarter of 2004. Under our current start-up plan, the Stendal mill underwent operational testing in December 2004 so that continuous production from the mill can commence. Our ongoing start-up of the Stendal mill is subject to risks commonly associated with the start-up of large greenfield industrial projects which could result in the Stendal mill experiencing operating difficulties or delays in the start-up period and the Stendal mill may not achieve our planned production, timing, quality or cost projections, which could have a material adverse effect on our results of operations, financial condition and cash flows. These risks include, without limitation, equipment failures or damage, errors or miscalculations in engineering, design specifications or equipment manufacturing, faulty construction or workmanship, defective equipment or installation, human error, industrial accidents, weather conditions, failure to comply with environmental and other permits, and complex integration of processes and equipment.

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

Approximately 72% of our sales from our German operations in the nine months ended September 30, 2004 were in products quoted in U.S. dollars while most of our operating costs and expenses at our German operations are incurred in Euros. Further, the Celgar mill only produces NBSK pulp which is quoted in U.S. dollars, while its costs are largely denominated in Canadian dollars. Our results of operations and financial condition are reported in Euros. As a result, our revenues have been adversely affected by the significant decrease of the U.S. dollar relative to the Euro. Additionally, an increase in the value of the Canadian dollar relative to the Euro, except to the extent offset by our derivatives strategy, would increase our costs at the Celgar mill as reported in Euros. Such shifts in currencies relative to the Euro would reduce our operating margin 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.

Stendal has entered into variable-to-fixed interest rate swaps to fix interest payments under the Stendal project financing facility, which had kept Stendal from benefiting from the general decline in interest rates in the latter part of 2002 and first half of 2003. These derivatives are marked to market at the end of such reporting period and all unrealized gains and losses are recognized in earnings for the relevant reporting periods.

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

Wood chips and pulp logs comprise the fiber used by the Rosenthal, Stendal and Celgar mills. The fiber used by our paper mills consists of waste paper and pulp. Such fiber is cyclical in terms of both price and supply. The cost of wood chips and pulp logs is primarily affected by the supply and demand for lumber. The cost of fiber for our paper mills is primarily affected by the supply and demand for paper and pulp. Demand for these raw materials is determined by the volume of pulp and paper products produced globally and regionally. The markets for pulp and paper products, including our products, are highly variable and are characterized by periods of excess product supply due to many factors, including periods of insufficient demand due to weak general economic activity or other causes. The cyclical nature of pricing for these raw materials represents a potential risk to our profit margins if pulp producers are unable to pass along price increases to their customers.

We do not own any timberlands or have any long-term governmental timber concessions. We do not have any long-term fiber contracts at our German operations and only a portion of Celgar's fiber requirements are covered by such contracts. Although raw materials are available from a number of suppliers, and we have not historically experienced supply interruptions or substantial price increases, our requirements will increase as the Stendal mill approaches its full production capacity and we may not be able to purchase sufficient quantities of these raw materials to meet our production requirements at prices acceptable to us during times of tight supply. In addition, the quality of fiber we receive could be reduced as a result of industrial disputes, material curtailments or shut-down of operations by suppliers, government orders and legislation, acts of god and other events beyond our control. An insufficient supply of fiber or reduction in the quality of fiber we receive would materially adversely affect our business, financial condition, results of operations and cash flow.

In addition to the supply of wood fiber, we are dependent on the supply of certain chemicals and other inputs used in our production facilities. Any disruption in the supply of these chemicals or other inputs could affect our ability to meet customer demand in a timely manner and would harm our reputation. Any material increase in the cost of these chemicals or other inputs could have a material adverse effect on our business, results of operations, financial condition and cash flows.

We operate in highly competitive markets.

We sell our products produced at our German operations primarily in Europe and the products produced at the Celgar mill are sold primarily in Asia and North America. The markets for our products are highly competitive. A number of other global companies compete in each of these markets and no company holds a dominant position. For both pulp and paper, many companies produce products that are largely standardized. As a result, the primary basis for competition in our markets has been price. Many of our competitors have greater resources and lower leverage than we do and may be able to adapt more quickly to industry or market changes or devote greater resources to the sale of products than we can. There can be no assurance that we will continue to be competitive in the future.

We are subject to risks related to our employees.

The majority of our employees in Germany and most of those at the Celgar mill are unionized. The collective agreement relating to employees at our paper mills in Germany expires in the third quarter of 2005. We expect to negotiate a new collective agreement with employees at our paper mills in Germany in the fourth quarter of 2005. The collective agreement relating to our pulp workers in Germany expires in the first quarter of 2005. We expect to negotiate a new collective agreement with

our pulp workers in Germany in the first half of 2005. A collective bargaining agreement with relation to employees at the Celgar mill was entered into in 2003 and expires in 2008. Although we have not experienced any work stoppages in the past, there can be no assurance that we will be able to negotiate acceptable collective agreements with our employees upon the expiration of the existing collective agreements. This could result in a strike or work stoppage by the affected workers. The renewal of the collective agreements or the outcome of our wage negotiations could result in higher wages or benefits paid to union members. Accordingly, we could experience a significant disruption of our operations or higher on-going labor costs, which could have a material adverse effect on our business, financial condition, results of operations and cash flow.

Risks Related to this Offering

We are a holding company and we are substantially dependent on cash provided by our subsidiaries to meet our debt service obligations under the notes.

We are a holding company that conducts substantially all of our operations through our subsidiaries. Because we are a holding company, the notes are effectively subordinated to all existing and future indebtedness and other liabilities of our subsidiaries. As of September 30, 2004, the aggregate outstanding liabilities of our subsidiaries was approximately €1,001.6 million, excluding inter-company amounts, including approximately €711.1 million of indebtedness for borrowed money.

Our subsidiaries are separate and distinct legal entities. Our subsidiaries have not guaranteed the notes and have no obligation to pay any amounts due on the notes. With limited exceptions, our subsidiaries are not required to provide us with funds for our payment obligations, whether by dividends, distributions or loans. In addition, payments of dividends, distributions, loans or advances by our subsidiaries to Mercer Inc. may be subject to contractual restrictions. The loan facilities of our subsidiaries do not contain any express provisions to permit distributions for debt servicing by Mercer Inc. Payments to Mercer Inc. by our subsidiaries will also be contingent upon our subsidiaries' earnings and other business considerations.

The notes will be effectively subordinated to all liabilities of our subsidiaries and are unsecured. We may not have sufficient funds to pay our obligations under the notes if we encounter financial difficulties.

The notes are not guaranteed and our subsidiaries have no obligations in respect of the notes. As a result, the notes are effectively subordinated to all liabilities of our subsidiaries. In the event of a bankruptcy, liquidation or reorganization involving us or any of our subsidiaries and in certain other events, our assets will be available to pay obligations on the notes only after all liabilities of our subsidiaries (including trade creditors) have been paid in full. After satisfying these obligations, we may not have sufficient assets remaining to pay amounts due on any or all of the notes then outstanding. Our incurrence of additional debt and other liabilities could adversely affect our ability to pay our obligations under the notes.

Despite our and our subsidiaries' current levels of indebtedness, we may incur substantially more debt, which could further increase the risks associated with our substantial indebtedness.

Although the indenture governing the notes will contain restrictions on the incurrence of additional indebtedness by us and our restricted subsidiaries, these restrictions are subject to a number of qualifications and exceptions, and the indebtedness incurred in compliance with these restrictions could be substantial. In addition to amounts that may be borrowed under our existing credit facilities, the indenture governing the notes also will allow us and our restricted subsidiaries to borrow significant amounts of money from other sources and will place no restrictions on borrowings by our unrestricted subsidiaries. Also, these restrictions do not prevent us from incurring obligations that do not constitute "indebtedness" as defined in the relevant agreement. If new debt is added to the current debt levels, the related risks that we now face could intensify.

The agreements governing our indebtedness contain significant restrictions that limit our operating and financial flexibility.

The indenture and our new revolving credit facilities contain covenants that, among other things, limit our ability to:

incur additional indebtedness and issue preferred stock;

pay dividends and make distributions;

repurchase stock or repay subordinated indebtedness;

make certain investments;

transfer, sell or make certain dispositions of assets or engage in sale and leaseback transactions;

incur liens;

enter into transactions with affiliates;

create dividend or other payment restrictions affecting restricted subsidiaries; and

merge, consolidate, amalgamate or sell or substantially all of our assets to another person.

In addition, our new revolving credit facilities require us to maintain specified financial ratios, and we may be unable to meet such ratios. All of these restrictions may limit our ability to execute our business strategy. Moreover, if operating results fall below current levels, we may be unable to comply with these covenants. If that occurs, our lenders could accelerate our indebtedness, in which case we may not be able to repay all of our indebtedness, and your notes may not be repaid fully, if at all.

We may not have sufficient funds or may be restricted in our ability to repurchase the notes upon a change in control.

The indenture governing the notes contains provisions that apply to a change in our control. You may require us to repurchase all or any portion of your notes upon a change in control. We may not have sufficient funds to repurchase the notes upon a change in control. The current project loan facilities of our subsidiaries limit our subsidiaries' ability to make cash disbursements to us and future debt agreements may prohibit us from paying the repurchase price. If we are prohibited from repurchasing the notes, we could seek consent from our lenders to make distributions to repurchase the notes. If we are unable to obtain consent, we could attempt to refinance the notes. If we are unable to obtain a consent or refinance, we would be prohibited from repurchasing the notes. If we are unable to repurchase the notes upon a change in control, it would result in an event of default under the indenture. An event of default under the indenture could result in a further event of default under our other then-existing debt. In addition, the occurrence of the change in control may be an event of default under our other debt. Our ability to repurchase the notes in such event may be limited by law, the indenture, or the terms of other agreements relating to our senior indebtedness.

An active or liquid trading market may not develop for the notes.

The notes will constitute a new issue of securities for which there is no established trading market. We do not intend to apply for listing or quotation of the notes on any securities exchange or automated quotation system. The underwriters may make a market for the notes and assist in their resale, but are not obligated to do so. Any market making activity may be discontinued at any time for any reason, without notice, after this offering is completed. We cannot predict whether an active trading market for the notes will develop or, if such market develops, how liquid it will be. If an active market for the notes fails to develop or to be sustained, the trading price of the notes could fall. Even if an active trading market were to develop, the notes could trade at prices that may be lower than the initial offering price of the notes, or the holders could experience difficulty or an inability to resell the notes.

The market price of the notes may be volatile.

You may not be able to sell your notes at a particular time or at a price favorable to you. Future trading prices of the notes will depend on many factors, including:

our operating performance and financial condition;

the interest of securities dealers in making a market;

the market for similar securities;

prevailing interest rates; and

general economic conditions.

Historically, the market for non-investment grade debt has been subject to disruptions that have caused substantial volatility in prices. The market for the notes, if any, may be subject to similar disruptions. A disruption may have a negative effect on you as a holder of the notes, regardless of our prospects or performance.

USE OF PROCEEDS

We estimate the net proceeds from our offering of the senior notes under this prospectus supplement to be approximately \$300.5 million, after deducting the underwriters' discounts and commissions and estimated offering expenses payable by us.

We intend to use the net proceeds from this offering, the estimated net proceeds, before expenses, from the concurrent Share Offering of \$75.8 million, assuming no exercise of the over-allotment option, and cash on hand to pay the cash portion of the purchase price of the Acquisition, the amount for the defined working capital of the Celgar mill on closing of the Acquisition, the estimated transaction costs of the Acquisition and to refinance all of the net bank indebtedness of our Rosenthal mill. See "The Acquisition".

The purchase price for the Acquisition will be paid to KPMG Inc., as receiver for Celgar. Subject to the payment of customary receiver, trustee and bankruptcy related fees, costs and expenses, the sales proceeds received by KPMG Inc. from the sale of the Celgar mill to us will be disbursed by it to the senior secured lenders of Celgar who are owed in excess of C\$875 million. Royal Bank of Canada, which is the indirect parent company of RBC Capital Markets Corporation, one of the underwriters in this offering and in the Share Offering, is a 50% holder of Celgar's senior secured indebtedness.

The anticipated sources and uses of funds for the Acquisition and the repayment of Rosenthal's debt are as follows as at September 30, 2004 on a pro forma basis (€ in millions):

Sources		Uses	
Notes issued under this prospectus supplement	€ 249.7	Cash portion of Acquisition purchase price	€ 136.9
Share Offering	64.5	Amount for Celgar working capital ⁽¹⁾	13.2
		Repayment of net Rosenthal debt ⁽²⁾	151.7
Cash on hand	1.3	Estimated fees, expenses, discounts and commissions for the Acquisition and the Financings	13.7
	<u> </u>		<u> </u>
Total sources	€ 315.5	Total uses	€ 315.5
	<u> </u>		<u> </u>

(1) Estimated as at September 30, 2004.

(2) As at September 30, 2004 and including the marked-to-market value of settling existing derivative instruments relating thereto and net of restricted cash of €28.5 million which shall be applied to retire such debt. The long-term indebtedness relating to the Rosenthal project finance facility bears an effective interest rate of 4.63% after taking into account certain interest rate derivatives relating thereto and is amortizing with a final maturity in 2013. The long-term indebtedness relating to the Rosenthal landfill bears interest at 6.71% and is amortizing with a final maturity in 2013.

THE FINANCINGS

In conjunction with the Acquisition, we are also offering approximately 9.4 million shares of beneficial interest for estimated net proceeds, before expenses, of approximately \$75.8 million, assuming no exercise of the over-allotment option. The net proceeds from this offering, the net proceeds from the concurrent Share Offering and cash on hand will be utilized to pay the cash portion of the purchase price of the Acquisition, the amount for the defined working capital of the Celgar mill on closing of the Acquisition, the transaction costs of the Acquisition and to refinance all of the net bank indebtedness of our Rosenthal mill. As at September 30, 2004, our Rosenthal mill had bank indebtedness of approximately €150.2 million, net of restricted cash of €28.5 million (\$186.5 million, net of restricted cash of \$35.4 million). The completion of the Senior Note Offering and the Share Offering are each contingent upon the other. Both such offerings are contingent upon the satisfaction or waiver of all conditions relating to the Acquisition other than the condition relating to the Financings.

Effective on the completion of the Acquisition, we intend to establish a new revolving working capital facility for the Rosenthal mill in the amount of €40 million with an initial term of five years and for the Celgar mill in the amount of \$30 million with an initial term of one year which, if not renewed, will convert to a one year term loan. We have received term sheets from two financial institutions relating to the provision of such working capital facilities upon terms and conditions customary for facilities of this nature. For more information relating to these new working capital facilities, see "Description of Certain Indebtedness - New Working Capital Facilities".

RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our ratio of earnings to fixed charges for the periods indicated:

	Year Ended December 31,					Nine Months Ended September 30,		Pro Forma ⁽¹⁾		
	1999 ⁽²⁾	2000	2001	2002	2003	2003	2004	Year Ended Dec. 31, 2003	Nine Months Ended September 30, 2003 2004	
Ratio of earnings to fixed charges ⁽³⁾	(4)	3.11	0.83 ⁽⁴⁾	(4)	0.32 ⁽⁴⁾	(4)	(4)	0.31 ⁽⁴⁾	(4)	0.05 ⁽⁴⁾

- (1) Pro forma gives effect to the Financings, the Acquisition, related transactions and the payment of estimated fees and expenses as if they had occurred at the beginning of the period for the nine months ended September 30, 2003 and 2004 and the year ended December 31, 2003.
- (2) In 1999, we effected the conversion of our Rosenthal mill from a sulphite to a kraft process, which resulted in production downtime from July to December of that year.
- (3) For purposes of computing the ratio of earnings to fixed charges, earnings consists of income before income taxes, minority interest, income (loss) from equity investee and fixed charges. Fixed charges consist of interest expense plus capitalized interest.
- (4) For the years ended December 31, 1999, 2001, 2002 and 2003, our deficiency of earnings to fixed charges was €44.0 million, €2.7 million, €20.7 million and €19.5 million, respectively. For the nine months ended September 30, 2003 and 2004, our deficiency of earnings to fixed charges was €29.0 million and €43.2 million, respectively. On a pro forma basis for the year ended December 31, 2003, and nine months ended September 30, 2003 and 2004, our deficiency of earnings to fixed charges was €29.9 million, €57.8 million and €45.7 million, respectively.

CAPITALIZATION

Capitalization is the amount invested in a company and is a common measurement of a company's size. The following table sets forth the consolidated cash, restricted cash and capitalization as at September 30, 2004 on an actual basis for Mercer and as adjusted to reflect the Financings, the Acquisition, related transactions and the payment of estimated fees and expenses, and as further adjusted to reflect these matters on our restricted group. You should read this table in conjunction with the consolidated financial statements and related notes of Mercer and the unaudited pro forma consolidated financial statements included elsewhere in this prospectus supplement.

	As at September 30, 2004		
	Actual	Pro Forma	Pro Forma Restricted Group ⁽¹⁾
	(unaudited) (in thousands)		
Cash and cash equivalents	€ 42,643	€ 41,310 ⁽²⁾	€ 35,351
Restricted cash	€ 76,884	€ 48,420 ⁽³⁾	
Current debt:			
Debt, current portion, and note payable	€ 16,868 ⁽⁴⁾	€ 1,779	€
Debt, Stendal	50,000	50,000	
Long-term debt:			
Debt, Stendal, less current portion ⁽⁵⁾	476,301	476,301	
Senior notes offered hereby ⁽⁶⁾		249,658	249,658
Debt, less current portion	234,317 ⁽⁷⁾	70,715 ⁽⁸⁾	66,441 ⁽⁹⁾
Total long-term debt	710,618	796,674	316,099
Total debt	777,486	848,453	316,099
Minority interest			
Shareholders' equity:			
Preferred shares, no par value; 50,000,000 authorized and issuable in series			
Series A, 500,000 authorized, none issued and outstanding			
Series B, 3,500,000 authorized, none issued and outstanding			
Shares of beneficial interest, \$1 par value; unlimited authorized; 17,324,229 and 30,950,951 ⁽¹⁰⁾ issued and outstanding in the actual and pro forma periods	79,736	173,024	N/A
Additional paid-in capital, stock options	14	14	N/A
Retained earnings	36,592	36,592	N/A
Accumulated other comprehensive income ⁽¹¹⁾	5,253	5,253	N/A
Total shareholders' equity	121,595	214,883	192,590
Total capitalization	€ 899,081	€ 1,063,336	€ 508,689

(1) Pro forma restricted group capitalization excludes financial data as it relates to Stendal and Dresden, which will be designated as unrestricted subsidiaries under the indenture governing the notes.

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- (2) Reflects net cash expected from this offering and the Share Offering less amounts used to pay the cash portion of the Acquisition purchase price, repay all of the net bank indebtedness of the Rosenthal mill, complete certain related transactions and pay estimated fees and expenses.
- (3) Comprised of €29.3 million for payment of construction in progress costs payable and €19.1 million in a debt service account, both relating to the Stendal project. Excludes a further €28.5 million in a debt service account relating to the Rosenthal mill that will be used in connection with the repayment of all of the bank indebtedness of the Rosenthal mill.

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- (4) Includes €15.1 million of bank indebtedness related to the Rosenthal mill which is to be repaid from the proceeds of the Financings.
- (5) As at September 30, 2004, we had construction costs payable of €161.0 million which are expected to be paid through drawdowns utilizing the Stendal project finance facility, thereby increasing debt, Stendal, less current portion.
- (6) Comprised of \$310 million of senior notes converted into Euros at a rate of €0.8053 per U.S. dollar as at September 30, 2004.
- (7) Comprised of €163.6 million of bank indebtedness related to the Rosenthal mill which is to be repaid from the proceeds of the Financings, €4.3 million of indebtedness, less current portion, related to our paper operations and €66.4 million aggregate principal amount of 8.5% convertible senior subordinated notes due October 2010, convertible at any time by the holder into our shares of beneficial interest at \$7.75 per share.
- (8) Includes €4.3 million of indebtedness, less current portion, related to our paper operations and €66.4 million aggregate principal amount of 8.5% convertible senior subordinated notes due October 2010, convertible at any time by the holder into our shares of beneficial interest at \$7.75 per share, but excludes €241.6 million of indebtedness from this offering.
- (9) Reflects €66.4 million aggregate principal amount of 8.5% convertible senior subordinated notes due October 2010, convertible at any time by the holder into our shares of beneficial interest at \$7.75 per share, but excludes €241.6 million of indebtedness from this offering. In addition, Mercer Inc., a member of the restricted group, has guaranteed five credit facilities, aggregating approximately €4.7 million, relating to the paper operations which are operated by an unrestricted subsidiary.
- (10) Assumes the issuance of 4,210,526 of our shares of beneficial interest as partial consideration for the Acquisition and 9,416,196 of our shares of beneficial interest pursuant to the Share Offering.
- (11) Reflects unrealized losses on securities and foreign currency translation adjustments.

THE ACQUISITION

Summary of Acquisition Agreement

On November 22, 2004, we entered into an agreement, referred to as the "Acquisition Agreement", with KPMG Inc., as receiver of Celgar, to acquire substantially all of the assets of Celgar. The assets to be acquired are substantially all of the operating assets of Celgar, including real property, plant and equipment, personal property, leaseholds, contractual interests and intellectual property. We are not acquiring certain assets of Celgar comprised principally of finished goods inventory, receivables, cash on hand and certain insurance claims. Pursuant to the Acquisition Agreement, we will assume various employment, pension and benefit, asset retirement and contractual obligations of Celgar. We are not assuming any obligations for any current liabilities of Celgar as at the date of closing, except for certain accrued employee liabilities, or any indebtedness of Celgar, whether incurred pre- or post-bankruptcy.

A copy of the Acquisition Agreement is attached as an exhibit to our Form 8-K filed with SEC on November 23, 2004 and the summary of the Acquisition Agreement is qualified in its entirety by reference to the full text of the agreement.

Subject to certain adjustments and excluding fees and expenses, the purchase price for the Acquisition is \$210 million, consisting of \$170 million payable in cash and \$40 million payable in our shares of beneficial interest, with an adjustment for the defined working capital at the Celgar mill on closing of the Acquisition. We estimate the additional amount that will be required for the working capital payment to be approximately \$16 million as at September 30, 2004. Our shares to be issued as part of the consideration for the Acquisition will be issued at a price equal to the volume weighted average trading price of our shares on the Nasdaq National Market during the period of 20 consecutive trading days ending on the fifth business day prior to the closing date of the Acquisition, subject to a minimum price of \$7.75 and a maximum price of \$9.50.

The cash portion of the purchase price and the working capital amount is to be funded in part from the proceeds of the Share Offering and the balance is to be funded from this offering. See "The Financings".

On closing of the Acquisition, we will add approximately 420 employees to our operations who were previously employees of Celgar. The initial positions, base salaries and benefits of such employees will be comparable to the positions, salaries and benefits held by them immediately prior to closing. The terms of employment, salaries and benefits applicable to such employees are comparable to other similarly situated employees in the pulp business in British Columbia, Canada.

The Acquisition is subject to various conditions, including financing satisfactory to us and the establishment of new working capital facilities for the Celgar mill and Rosenthal mill. The completion of the Acquisition is also conditional upon certain regulatory approvals, including the expiration or earlier termination of the applicable statutory waiting periods under the *Competition Act* (Canada) and the *Hart-Scott-Rodino Antitrust Improvements Act of 1976*, and a determination that the Acquisition is of net benefit to Canada under the *Investment Canada Act* (Canada). Substantially all of the conditions must be satisfied or waived prior to the issuance of our notes hereunder.

The Acquisition Agreement contains customary representations and warranties of the vendor covering various matters, many of which are qualified by the vendor's knowledge after reasonable investigation and some of which are limited in scope to the receivership period extending from July 23, 1998 to the closing date. Additionally, the vendor's environmental compliance representation and warranty in the Acquisition Agreement is limited in scope to the compliance period of November 15, 2003 to the closing date and certain specified environmental statutes, regulations and rules. The vendor's environmental representations and warranties survive the closing for a period of 12 months

after the closing date and all other representations and warranties made by the parties survive the closing for a period of 15 months after the closing date.

In the case of misrepresentations or breaches of warranty by a party other than the vendor's environmental representations and warranties, the claiming party must incur aggregate damages in excess of \$0.5 million, in which event all such damages up to a maximum of \$30 million may be claimed by the claiming party. In the case of a misrepresentation or breach of warranty in respect of the vendor's environmental representations and warranties, Mercer must incur aggregate damages in excess of \$1 million, in which event all such damages up to a maximum of \$20 million may be claimed by Mercer.

Pursuant to the terms of the Acquisition, the vendor also entered into a lock-up agreement. Subject to certain exceptions, the lock-up agreement generally prohibits the vendor and its transferees, without the prior written consent of the underwriters, from selling, offering or agreeing to sell, hypothecating, pledging, granting an option to purchase or otherwise disposing of any of our shares of beneficial interest or securities convertible into or exchangeable or exercisable for our shares of beneficial interest or any warrants or other rights to purchase our shares of beneficial interest or such securities. These restrictions will be in effect for 180 days after the closing date of the Acquisition. In addition, pursuant to the terms of the Acquisition Agreement, we entered into a registration rights agreement dated November 22, 2004 with the vendor pursuant to which we have agreed to file a registration statement under the Securities Act of 1933, as amended, or the "Securities Act", to register our shares of beneficial interest to be issued as part of the consideration of the Acquisition within 90 days of the closing date of the Acquisition and to use our commercially reasonable efforts to have the registration statement declared effective within 180 days of the closing date of the Acquisition. Subject to certain exceptions, under the registration rights agreement, if: (i) we fail to file a registration statement covering such shares within 90 days from the closing date of the Acquisition; (ii) the registration statement is not declared effective within 180 days of the closing date of the Acquisition; (iii) the registration statement cannot be used for any reason after being declared effective; or (iv) such shares are not listed on Nasdaq, the New York Stock Exchange or the American Stock Exchange at any time after the deadline for the effectiveness of the registration statement, we are required to pay the vendor liquidated damages equal to an amount determined by multiplying the aggregate purchase price of our shares of beneficial interest held by the vendor by a rate equal to the prime rate set forth in the registration rights agreement plus 2% per annum for each 30-day period (or portion thereof) during which we are in such default. The registration rights agreement also provides piggy-back registration rights for future equity offerings.

Acquisition Rationale

The Acquisition of the Celgar mill reflects our strategy of acquiring world-class NBSK pulp production capacity on terms below comparable replacement cost where we can use our management focus to enhance operations, improve profitability and create value for our stakeholders. It provides us with several strategic benefits and synergies, including the following:

Enhancing Our Position as a Leading Market NBSK Pulp Producer. The Acquisition will make us one of the largest producers of market NBSK pulp in the world. We will have a consolidated annual production capacity of approximately 1.3 million ADMTs of high quality NBSK pulp from three modern NBSK pulp mills located in Europe and North America. We believe this will improve our service to those larger paper and tissue producing customers who wish to develop purchasing arrangements with pulp suppliers that can service them on a worldwide basis.

Creating Value Through Active Management. We believe we can leverage our management focus and turnaround experience to enhance the Celgar mill's operating performance by improving

price realizations, increasing production and reducing production costs. See " Acquisition Opportunities".

Diversifying Our Revenue and Cost Base. In 2003, substantially all of Mercer's revenues resulted from sales in Europe. Approximately 69% of the Celgar mill's sales in 2003 were in Asia, which is the fastest growing market for NBSK pulp imports. The Celgar mill's costs are largely in Canadian dollars, which should reduce our relative exposure to the exchange rate between the U.S. dollar and Euro.

Given our management team's experience in converting and optimizing the Rosenthal mill, constructing the Stendal mill and starting up these large scale NBSK pulp mills, we believe we are well positioned to integrate the Celgar mill into our operations and to improve its operating and financial performance over time. We have identified teams of individuals in our organization, at the Celgar mill and from our consulting engineers that, upon the closing of the Acquisition, will initiate the process of integrating the Celgar mill and enhancing its operations.

Acquisition Opportunities

Although the Celgar mill is a modern facility that has generally been well maintained, we believe the mill has not performed at its full potential. As the Celgar mill has been operated by a trustee in bankruptcy since 1998, we believe that there are a number of opportunities that will enable us to enhance the Celgar mill's performance and we are currently targeting C\$25 million in annual operating margin improvements over a three-year period, based on current pricing levels. These opportunities include the following:

Improving Price Realizations. We understand that, in 2003, the Celgar mill's pulp price realizations were approximately C\$38 per ADMT below the average for NBSK pulp mills in British Columbia, Canada. We believe that this resulted from a combination of the mill's current sales arrangements, its product classification and a history of inconsistent production.

Since its assignment into bankruptcy, agents under the supervision of KPMG Inc. have conducted all of the Celgar mill's sales. The mill has lost, or is generally unable to obtain, regular contract sales with customers. Instead, Celgar has relied upon spot sales through third party agents who are generally more focused on volume than price or reducing transportation costs by focusing on the most freight logical customers. We intend to have our existing sales force take over responsibility for supervising and managing all of the Celgar mill's agent sales and perform some of its sales functions directly on a coordinated global basis with our Rosenthal and Stendal mills over time. We believe this will permit us to reduce agents' fees, lower transportation costs, improve price realizations and service our larger customers on a global basis.

The Celgar mill has also suffered lower pulp price realizations as a result of the amount of pulp it classifies as off-grade, primarily because of variations in brightness. It sells such pulp at a substantial discount in the spot market. In 2003, the Celgar mill had off-grade sales of approximately 15% of its total sales, compared to less than 2% at our Rosenthal mill. We believe that we can substantially reduce the amount of such off-grade sales by adding to the number of grades of pulp marketed by the mill and more effectively matching it with customer requirements. We believe that minor variations in brightness would not require such pulp to be sold at a discount to many customers. We also intend to improve the mill's pulp brightness consistency through an upgrade of the EOP washer at the mill. Because of the overall product characteristics of the NBSK pulp produced at the Celgar mill and our experience in managing and coordinating sales at our Rosenthal and Stendal mills, we plan to eliminate or reduce the price realization discount incurred by the Celgar mill in comparison to other NBSK pulp mills in British Columbia, Canada, over time.

Increasing Production. We, in conjunction with our consulting engineers, have identified certain high return strategic capital projects that we believe can increase the production of the Celgar mill, along with lowering its operating costs and improving its reliability. Significant strategic capital projects include improvements to deknottling and screening facilities, installation of an EOP washer, optimization of the mill's steam balance with the addition of a steam condenser and enhancements to the mill's drying capacity.

Through these identified strategic capital projects, along with other enhancements and debottlenecking initiatives, we plan to increase the Celgar mill's annual production capacity to approximately 470,000 ADMTs over time. We have successfully implemented similar initiatives at our Rosenthal mill which increased its annual production capacity from approximately 280,000 ADMTs to approximately 310,000 ADMTs over a three-year period.

Lowering Production Costs. We believe that we can reduce the Celgar mill's production costs by improving its operating consistency and reliability. We plan to achieve such improvements through strategic capital projects such as the installation of the EOP washer. The washer project is designed to reduce costs, improve pulp brightness and improve mill reliability.

Although the Celgar mill has generally been well maintained, we believe that there has been a limited focus on "preventative maintenance" such as we conduct at our Rosenthal mill and we will conduct at our Stendal mill. We believe that a combined management and work force focus on preventative maintenance will enhance running time, reliability and efficiency. We intend to bring many of the existing best practices we have developed at our other mills to the Celgar mill by way of investments in training and leadership. Improved consistency of operations would also allow the Celgar mill to reduce unnecessarily high energy costs. The mill has the capacity to generate approximately 48 megawatts of energy while its steady state consumption requirements are approximately 36 megawatts. Although the mill exports energy from time to time, due to variable mill operations and internal system imbalances, it has also purchased substantial amounts of energy in the past. Once we have implemented our planned strategic capital projects, and assuming we have maximized reliability through best preventative maintenance practices, we believe the mill should generate approximately 46 megawatts of energy and be a consistent net exporter of power. Similar to the efficiencies we have achieved since the start-up of the Rosenthal mill, where natural gas usage has declined by 45%, we believe that over time the Celgar mill should be able to consume substantially less natural gas and has the potential to reduce its energy costs by up to 50%.

We have estimated the amount to be spent on the strategic capital projects referred to above to be an aggregate of approximately C\$25 million over a three-year period. The most significant such project is the installation of the EOP washer at an aggregate approximate cost of C\$8.5 million.

We have an experienced management team that has overseen the conversion and expansion of our Rosenthal mill. Our management team has also overseen the construction of the Stendal mill and is overseeing its start-up. We believe our management team will be able to bring their expertise and management practices to the Celgar mill to enhance the mill's performance.

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

The following sets forth the unaudited pro forma consolidated financial statements of the Company as at and for the periods indicated. The unaudited pro forma consolidated financial statements have been prepared by us and give pro forma effect to the Senior Note Offering, the Share Offering, the Acquisition, the refinancing of the bank indebtedness of our Rosenthal mill, the related transactions and the payment of estimated fees and expenses. For a more detailed discussion of the basis of presentation, see note 1 to the unaudited pro forma consolidated financial statements of the Company. The unaudited pro forma consolidated financial statements and related notes should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" of both Mercer and Celgar included elsewhere in this prospectus supplement. The pro forma information is presented for illustrative purposes only and does not purport to represent what our actual results of operations or financial position would have been had the matters described above occurred on the dates assumed, nor is it necessarily indicative of our future operating results or combined financial position. The information reflects the operations of Celgar prior to the Acquisition.

Mercer prepares its financial statements in accordance with GAAP. Celgar prepares its financial statements in accordance with Canadian generally accepted accounting principles, or "Canadian GAAP", which differs in certain respects from GAAP. For a discussion of the principal differences between Canadian GAAP and GAAP as they relate to Celgar and the Company on a pro forma basis, see Note 12 to Celgar's audited financial statements, and Note 5 to the unaudited pro forma consolidated financial statements of the Company.

MERCER INTERNATIONAL INC.

UNAUDITED PRO FORMA CONSOLIDATED BALANCE SHEET

September 30, 2004
(Expressed in thousands)

	Mercer International Inc.	Stone Venepal (Celgar) Pulp Inc.	Pro Forma Adjustments	Notes	Consolidated Pro Forma
ASSETS					
Current					
Cash and cash equivalents	€ 42,643	€	€ 300,464	4(a)(iii), (iv), 4(b)(ii), (iii), (iv)	€ 41,310
			(150,138)	3	
			(178,691)	4(b)(v)	
			(1,432)	4(b)(v)	
			28,464	4(b)(v)	
Cash restricted	29,346				29,346
Receivables	33,003	18,348	(18,316)	4(b)(i)	33,035
Unrealized foreign exchange derivative gains	899		(420)	4(b)(v)	479
Inventories	59,225	48,513	(27,443)	4(b)(i)	80,295
Prepaid expenses	4,603	882	(616)	4(b)(i)	4,869
Total current assets	169,719	67,743	(48,128)		189,334
Cash restricted	47,538		(28,464)	4(b)(v)	19,074
Property, plant and equipment	942,249	160,963	17,698	4(b)(i)(iv)	1,120,910
Investments	878				878
Equity method investments	3,993				3,993
Deferred note issuance costs	3,908		6,241	4(b)(ii)	10,149
Unrealized foreign exchange derivative gains	14,442				14,442
Other		569			569
Deferred income tax	10,000				10,000
Total assets	€ 1,192,727	€ 229,275	€ (52,653)		€ 1,369,349
LIABILITIES					
Current					
Bank indebtedness	€	€ 13,166	€ (13,166)	4(b)(i)	€
Accounts payable and accrued expenses	64,373	15,384	(12,733)	4(b)(i)	65,766
			(1,258)	4(b)(v)	
Construction costs payable	160,952				160,952
Note payable	1,403				1,403
Debt, Stendal	50,000				50,000
Debt, current portion	15,465	166	(166)	4(b)(i)	376
			(15,089)	4(b)(v)	
Total current liabilities	292,193	28,716	(42,412)		278,497
Debt, Stendal	476,301				476,301
Debt, less current portion	234,317	708,554	249,658	4(a)(iv)	320,373
			(708,554)	4(b)(i)	
			(163,602)	4(b)(v)	
Unrealized interest rate derivative loss	58,874				58,874
Unrealized foreign exchange derivative loss	594		(594)	4(b)(v)	
Pension plan and post retirement benefit obligation		10,953			10,953
Asset retirement obligation		615			615
Capital leases and other	8,853	111	(111)	4(b)(i)	8,853
Total liabilities	1,071,132	748,949	(665,615)		1,154,466

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	Mercer International Inc.	Stone Venepal (Celgar) Pulp Inc.	Pro Forma Adjustments	Notes	Consolidated Pro Forma
SHAREHOLDERS' EQUITY (CAPITAL DEFICIENCY)					
Shares of beneficial interest	79,736	11,342	64,458	4(a)(iii)	173,024
			(3,384)	4(b)(iii)	
			(11,342)	4(b)(i)	
			32,214	4(a)(ii)	
Additional paid-in capital, stock options	14				14
Retained earnings (deficit)	36,592	(528,066)	528,066	4(b)(i)	36,592
Accumulated other comprehensive income	5,253	(2,950)	2,950	4(b)(i)	5,253
Total shareholders' equity	121,595	(519,674)	612,962		214,883
Total liabilities and shareholders' equity	€ 1,192,727	€ 229,275	€ (52,653)		€ 1,369,349

See accompanying Notes to the Unaudited Pro Forma Consolidated Financial Statements

MERCER INTERNATIONAL INC.

UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

Nine months ended September 30, 2004
(Expressed in thousands, except per share data)

	Mercer International Inc.	Stone Venepal (Celgar) Pulp Inc.	Pro Forma Adjustments	Notes	Consolidated Pro Forma
Revenues					
Pulp and paper	€ 145,084	€ 132,036	€		€ 277,120
Transportation	2,134				2,134
Other	6,650				6,650
	<u>153,868</u>	<u>132,036</u>			<u>285,904</u>
Cost of sales					
Pulp and paper	131,420	117,034	(5,097)	4(c)(i)	243,357
Transportation	2,222				2,222
	<u>133,642</u>	<u>117,034</u>	<u>(5,097)</u>		<u>245,579</u>
Gross profit	20,226	15,002	5,097		40,325
General and administrative	(21,182)	(14,000)	598	4(c)(ii)	(34,584)
Impairment of capital assets	(6,000)	(79,389)	79,389	4(b)(i)	(6,000)
Flooding losses and expenses, less grant income	(669)				(669)
	<u>(7,625)</u>	<u>(78,387)</u>	<u>85,084</u>		<u>(928)</u>
Income (loss) from operations					
Other income (expense)					
Interest expense	(9,554)	(21,194)	10,432	4(c)(iii)	(20,901)
			(585)	4(c)(iv)	
Investment income	1,679		(1,123)	4(c)(vii)	556
Derivative financial instruments					
Unrealized gain on natural gas forward supply contracts		1,293			1,293
Unrealized loss on interest rate derivatives	(15,825)		101	4(c)(v)	(15,724)
Unrealized and realized gain on foreign exchange rate derivatives	14,748		174	4(c)(v)	14,922
Foreign exchange gain on term credit facility		9,448	(7,657)	4(c)(vi)	1,791
	<u>(8,952)</u>	<u>(10,453)</u>	<u>1,342</u>		<u>(18,063)</u>
Income (loss) before income taxes and minority interest	(16,577)	(88,840)	86,426		(18,991)
Income tax benefit	37				37
	<u>(16,540)</u>	<u>(88,840)</u>	<u>86,426</u>		<u>(18,954)</u>
Income (loss) before minority interest					
Minority interest	3,936				3,936

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	Mercer International Inc.	Stone Venepal (Celgar) Pulp Inc.	Pro Forma Adjustments	Notes	Consolidated Pro Forma
Net income (loss)	€ (12,604)	€ (88,840)	€ 86,426		€ (15,018)
Loss per share					
Basic	€ (0.73)				€ (0.49)
Diluted	€ (0.73)				€ (0.49)
Number of shares outstanding for computing basic and diluted loss per share	17,256,894				30,883,616

See accompanying Notes to the Unaudited Pro Forma Consolidated Financial Statements

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MERCER INTERNATIONAL INC.

UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

Year ended December 31, 2003
(Expressed in thousands, except per share data)

	Mercer International Inc.	Stone Venepal (Celgar) Pulp Inc.	Pro Forma Adjustments	Notes	Consolidated Pro Forma
Revenues					
Pulp and paper	€ 182,456	€ 171,169	€		€ 353,625
Transportation	3,607				3,607
Other	8,493				8,493
	<u>194,556</u>	<u>171,169</u>			<u>365,725</u>
Cost of sales					
Pulp and paper	176,655	170,044	(12,813)	4(d)(i)	333,886
Transportation	3,035				3,035
	<u>14,866</u>	<u>1,125</u>	<u>12,813</u>		<u>28,804</u>
Gross profit					28,804
General and administrative	(19,323)	(23,995)	1,485	4(d)(ii)	(41,833)
Settlement expenses	(1,041)				(1,041)
Flooding grants, less losses and expenses	957				957
	<u>(4,541)</u>	<u>(22,870)</u>	<u>14,298</u>		<u>(13,113)</u>
Loss from operations					(13,113)
Other income (expense)					
Interest expense	(11,523)	(30,312)	16,489	4(d)(iii)	(26,126)
			(780)	4(d)(iv)	
Investment income	1,653		(660)	4(d)(vii)	993
Derivative financial instruments					
Unrealized loss on natural gas forward supply contracts		(665)			(665)
Unrealized loss, construction in progress financing	(13,042)				(13,042)
Realized gain, construction in progress financing	743				743
Net gains (losses), other	28,467		(455)	4(d)(v)	28,012
Impairment of equity method investments	(2,255)				(2,255)
Impairment of available-for-sale securities	(5,570)				(5,570)
Foreign exchange gain on term credit facility		76,875	(62,304)	4(d)(vi)	14,571
	<u>(1,527)</u>	<u>45,898</u>	<u>(47,711)</u>		<u>(3,339)</u>
Total other expense					(3,339)
Income (loss) before income taxes and minority interest	(6,068)	23,028	(33,413)		(16,452)
Income tax provision	(3,172)				(3,172)
	<u>(9,240)</u>	<u>23,028</u>	<u>(33,413)</u>		<u>(19,624)</u>
Income (loss) before minority interest					(19,624)

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	Mercer International Inc.	Stone Venepal (Celgar) Pulp Inc.	Pro Forma Adjustments	Notes	Consolidated Pro Forma
Minority interest	5,647				5,647
Net income (loss)	€ (3,593)	€ 23,028	€ (33,413)		€ (13,977)
Loss per share					
Basic	€ (0.21)				€ (0.46)
Diluted	€ (0.21)				€ (0.46)
Number of shares outstanding for computing basic and diluted loss per share	16,940,858				30,567,580

See accompanying Notes to the Unaudited Pro Forma Consolidated Financial Statements

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MERCER INTERNATIONAL INC.

UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

Nine months ended September 30, 2003
(Expressed in thousands, except per share data)

	Mercer International Inc.	Stone Venepal (Celgar) Pulp Inc.	Pro Forma Adjustments	Notes	Consolidated Pro Forma
Revenues					
Pulp and paper	€ 134,935	€ 130,545	€		€ 265,480
Transportation	2,850				2,850
Other	6,351				6,351
	<u>144,136</u>	<u>130,545</u>			<u>274,681</u>
Cost of sales					
Pulp and paper	131,838	133,457	(9,505)	4(e)(i)	255,790
Transportation	2,388				2,388
	<u>134,226</u>	<u>133,457</u>	<u>(9,505)</u>		<u>258,178</u>
Gross profit (loss)	9,910	(2,912)	9,505		16,503
General and administrative					
Settlement expenses	(12,961)	(17,746)	1,235	4(e)(ii)	(29,472)
Impairment of capital assets	(630)				(630)
Flooding grants, less losses and expenses	1,162				1,162
	<u>(2,519)</u>	<u>(20,658)</u>	<u>10,740</u>		<u>(12,437)</u>
Other income (expense)					
Interest expense	(6,887)	(22,485)	11,839	4(e)(iii)	(18,118)
Investment income	1,055		(585)	4(e)(iv)	542
Derivative financial instruments			(513)	4(e)(vii)	(387)
Unrealized gain on natural gas forward supply contracts		(387)			(387)
Unrealized loss on interest rate derivatives	(22,832)		307	4(e)(v)	(22,525)
Unrealized and realized gain on foreign exchange rate derivatives	19,228		(18,642)	4(e)(v)	586
Net gain (losses), other	20				20
Impairment of equity method investments					
Impairment of available-for-sale securities	(5,511)				(5,511)
Foreign exchange gain on term credit facility		61,484	(49,830)	4(e)(vi)	11,654
	<u>(14,927)</u>	<u>38,612</u>	<u>(57,424)</u>		<u>(33,739)</u>
Income (loss) before income taxes and minority interest					
	(17,446)	17,954	(46,684)		(46,176)
Income tax (provision) benefit	(226)				(226)

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	Mercer International Inc.	Stone Venepal (Celgar) Pulp Inc.	Pro Forma Adjustments	Notes	Consolidated Pro Forma
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Income (loss) before minority interest	(17,672)	17,954	(46,684)		(46,402)
Minority interest	8,499				8,499
	<u> </u>	<u> </u>	<u> </u>		<u> </u>
Net income (loss)	€ (9,173)	€ 17,954	€ (46,684)		€ (37,903)
	<u> </u>	<u> </u>	<u> </u>		<u> </u>
Loss per share					
Basic	€ (0.54)				€ (1.24)
	<u> </u>				<u> </u>
Diluted	€ (0.54)				€ (1.24)
	<u> </u>				<u> </u>
Number of shares outstanding for computing basic and diluted loss per share	16,887,262				30,513,984
	<u> </u>				<u> </u>

See accompanying Notes to the Unaudited Pro Forma Consolidated Financial Statements

MERCER INTERNATIONAL INC.

NOTES TO THE UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2004

(Expressed in thousands, unless otherwise stated)

Note 1. Basis of Presentation

On November 22, 2004, we entered into an agreement with KPMG Inc., as receiver of Celgar, to acquire substantially all of the assets of Celgar (Note 3). The completion of the Acquisition is subject to, among other things, us raising from the sale of our equity and/or debt securities funds to finance the payment of the purchase price and refinance the net bank indebtedness of our Rosenthal pulp mill, on terms and conditions satisfactory to us, and us having accepted a commitment from a Canadian chartered bank or its affiliates for an operating credit facility of not less than US\$30 million. We have made certain assumptions in respect of the anticipated equity and debt to be issued to finance the Acquisition (Note 4). The Acquisition has been accounted for by the purchase method of accounting in accordance with Statement of Financial Accounting Standards No. 141, Business Combinations.

Our unaudited pro forma consolidated financial statements as at September 30, 2004 and for the nine months ended September 30, 2004 and 2003 and the year ended December 31, 2003 have been prepared by management after giving effect to the Acquisition, the anticipated equity and debt to be issued to finance the Acquisition and refinance the net bank indebtedness of our Rosenthal mill, the related transactions and the payment of estimated fees and expenses. These pro forma consolidated financial statements have been compiled from and include:

- (a) A pro forma consolidated balance sheet combining the unaudited consolidated balance sheet of Mercer as at September 30, 2004 with the unaudited balance sheet of Celgar as at September 30, 2004;
- (b) A pro forma consolidated statement of operations combining the unaudited consolidated statement of operations of Mercer for the nine months ended September 30, 2004 and 2003 with the unaudited statement of operations of Celgar for the nine months ended September 30, 2004 and 2003; and
- (c) A pro forma consolidated statement of operations combining the audited consolidated statement of operations of Mercer for the year ended December 31, 2003 with the audited statement of operations of Celgar for the year ended December 31, 2003.

The September 30, 2004 pro forma balance sheet has been prepared as if the transaction described in Note 3 had occurred on September 30, 2004. The pro forma statements of operations for the year ended December 31, 2003 and for the nine months ended September 30, 2004 and 2003 have been prepared as if the transactions described in Note 3 had occurred on January 1, 2003.

The pro forma statements have been presented in Euros which is the reporting currency for Mercer. The exchange rates used for conversion to Euros throughout these statements are included in the table below:

	<u>US\$</u>	<u>C\$</u>
As at September 30, 2004	1.2417	1.5694
Average for the Nine months ending September 30, 2004	1.2255	1.6275
Average for the Twelve months ending December 31, 2003	1.1321	1.5865
Average for the Nine months ending September 30, 2003	1.1124	1.5902

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It is management's opinion that these pro forma consolidated financial statements include all adjustments necessary for the fair presentation of the transactions described in Note 3 in accordance with GAAP applied on a basis consistent with Mercer's accounting policies. The pro forma consolidated financial statements are not intended to reflect the results of operations or the financial position of Mercer which would have actually resulted had the proposed transactions been effected on the dates indicated. Further, the pro forma financial information is not necessarily indicative of Mercer's financial position or results of operations that may be obtained in the future.

The unaudited pro forma financial statements should be read in conjunction with the historical financial statements and notes thereto of Celgar and Mercer included in this prospectus supplement and our quarterly report on Form 10-Q for the period ended September 30, 2004 filed with the SEC.

Note 2. Summary of Significant Accounting Policies

The unaudited pro forma consolidated financial statements have been compiled using the significant accounting policies as set out in the audited financial statements of Mercer for the year ended December 31, 2003 included in our annual report on Form 10-K for the year ended December 31, 2003 filed with the SEC. The significant accounting policies of Celgar, after adjustment into GAAP, conform in all material respects to those of Mercer. The differences between Canadian GAAP and GAAP which would have a material effect on these pro forma consolidated financial statements are reflected in Note 5.

Note 3. Business Acquisition

Celgar

Pursuant to the Acquisition Agreement dated November 22, 2004 between the Company, its wholly-owned subsidiary, 0706906 B.C. Ltd. and KPMG Inc. (in its capacity as receiver of Celgar), the Company has agreed to acquire substantially all of the assets of Celgar for a purchase price of €169,123 (US\$210,000), of which €136,909 (US\$170,000) is payable in cash and €32,214 (US\$40,000) is payable in shares of beneficial interest of Mercer, plus an amount for the defined working capital at the Celgar mill on the closing date of the Acquisition. We will not assume any of Celgar's debt, equity and other liabilities, except for certain accrued employee liabilities, pension plan and post retirement benefit obligations and asset retirement obligations. The purchase price is subject to certain adjustments and excludes fees and expenses. The aggregate purchase price of the Acquisition is estimated to be €186,379 (US\$231,427).

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The preliminary estimated allocation of the purchase price is summarized below and is subject to change. The actual allocation of the purchase price will be based upon the fair values of the net assets of Celgar at the date of acquisition.

Purchase price:	
Cash	€ 150,138
Equity shares of beneficial interest	32,214
Estimated acquisition costs	4,027
	€ 186,379
Net assets acquired:	
Receivables	€ 32
Inventory	21,070
Prepays	266
Property, plant and equipment	178,662
Other assets	569
Accrued liabilities	(2,652)
Asset retirement obligation	(615)
Pension plan and post-retirement benefits obligation	(10,953)
	€ 186,379

Celgar's unaudited balance sheet as at September 30, 2004, unaudited statement of operations for the nine months ended September 30, 2004 and 2003 and audited statement of operations for the year ended December 31, 2003 have been restated into GAAP and Euros as presented in Note 5.

The cash portion of the purchase price and the defined working capital amount will be financed from the partial net proceeds of the equity and debt offerings as described in Note 4(a).

Note 4. Pro Forma Adjustments

The respective pro forma adjustments are explained below beside the corresponding footnote:

- (a) General Assumptions:
- (i) The Company will acquire the assets as described in Note 3 from KPMG Inc., as receiver of Celgar.
 - (ii) The Company expects to issue 4,210,526 shares of beneficial interest at an assumed price of US\$9.50 per share which represents €32,214 (US\$40,000) of the purchase price as described in Note 3 as partial consideration for the Acquisition.
 - (iii) Assuming an issue price of US\$8.50, the Company intends to issue 9,416,196 shares of beneficial interest to raise gross proceeds of €64,458 (US\$80,038) to finance the Acquisition and to refinance the net bank indebtedness of our Rosenthal mill.

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- (iv) The Company intends to issue debt securities to raise gross proceeds of €249,658 (US\$310,000) to finance the Acquisition and to refinance the net bank indebtedness of our Rosenthal mill.

- (b) Assumptions for unaudited pro forma consolidated balance sheet as of September 30, 2004:

- (i) We will acquire substantially all the assets of Celgar through the Acquisition Agreement as described in Note 3.
- (ii) Estimated debt financing costs of €6,241 will be deferred and amortized over eight years, which is the expected term of the related debt.
- (iii) Estimated equity financing costs of €3,384 will be netted against the gross proceeds of equity issued.
- (iv) Acquisition costs estimated at €4,027 have been added to the cost of the Acquisition.
- (v) The Rosenthal debt of €178,691 and the associated unrealized net derivative liabilities of €1,432 will be settled and refinanced through proceeds from the debt and equity offerings and €28,464 of long-term restricted cash. This long-term restricted cash becomes unrestricted upon the settlement of the Rosenthal debt.

- (c) Assumptions for pro forma consolidated statements of operations for the nine months ended September 30, 2004:

- (i) Amortization expense has been decreased by €5,097 to reflect reduction in asset value and harmonization of depreciation policies.
- (ii) Reduce general and administrative expenses by €598 which are non-recurring professional costs related to the oversight of the Celgar mill by the receiver and trustee. These costs will not be incurred in the future as these services will be provided by the Company's senior officers.
- (iii) Reduced interest expense of €10,432 has been recorded to reflect the reversal of interest on the Celgar debt and the refinancings of the Rosenthal debt, offset by the €249,658 (US\$310,000) debt securities financing.
- (iv) Amortization of deferred financing costs of €585 has been charged to interest expense.
- (v) A decrease in unrealized loss on interest rate derivatives of €101 and an increase in unrealized and realized gain on foreign exchange rate derivatives of €174 to reflect derivatives settled on the refinancing of the Rosenthal debt. These derivatives and the Rosenthal debt will be settled and refinanced with partial proceeds from the issuance of our debt securities.
- (vi) A decrease in foreign exchange gain of €7,657 on the Celgar term facility to reflect the new financing inherent in the Acquisition. The Company will not be assuming such Celgar term facility pursuant to the Acquisition (Note 3).

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- (vii) Reduced investment income of €1,123 to reflect the reduction of interest earned on restricted cash utilized in the refinancing of the Rosenthal debt.
 - (viii) No tax expense has been recorded for items (i) thru (vii) above as the Company has sufficient tax loss carry-forwards available that could be utilized against taxes payable. The Company maintains a valuation reserve against the majority of these loss carry-forwards due to uncertainties regarding future taxable income.
- (d) Assumptions for pro forma consolidated statement of operations for the year ended December 31, 2003:
- (i) Amortization expense has been decreased by €12,813 to reflect reduction in asset value and harmonization of depreciation policies.
 - (ii) Reduce general and administrative expenses by €1,485 which are non-recurring professional costs related to the oversight of the Celgar operations by the receiver and trustee in bankruptcy. These costs will not be incurred in the future as these services will be provided by the Company's senior officers.
 - (iii) Reduced interest expense of €16,489 has been recorded to reflect the reversal of interest on the Celgar debt and the refinancing of the Rosenthal debt, offset by the €249,658 (US\$310,000) debt securities financing.
 - (iv) Amortization of deferred financing costs of €780 has been charged to interest expense.
 - (v) A decrease in net gain (losses), other of €455 to reflect derivatives settled on the refinancing of the Rosenthal debt. These derivatives and the Rosenthal debt will be settled and refinanced with partial proceeds from the issuance of our debt securities.
 - (vi) A decrease in foreign exchange gain of €62,304 on the Celgar term facility to reflect the new financing inherent in the Acquisition. The Company will not be assuming such Celgar term facility pursuant to the Acquisition (Note 3).
 - (vii) Reduced investment income by €660 to reflect the reduction of interest earned on restricted cash utilized in the refinancing of the Rosenthal debt.
 - (viii) No tax expense has been recorded for items (i) thru (vii) above as the Company has sufficient tax loss carry-forwards available that could be utilized against taxes payable. The Company maintains a valuation reserve against the majority of these loss carry-forwards due to uncertainties regarding future taxable income.
- (e) Assumptions for pro forma consolidated statements of operations for the nine months ended September 30, 2003:
- (i) Amortization expense has been decreased by €9,505 to reflect reduction in asset value and harmonization of depreciation policies.

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- (ii) Reduce general and administrative expenses by €1,235 which are non-recurring professional costs related to the oversight of the Celgar mill by the receiver and trustee. These costs will not be incurred in the future as these services will be provided by the Company's senior officers.
- (iii) Reduced interest expense of €11,839 has been recorded to reflect the reversal of interest on the Celgar debt and the refinancing of the Rosenthal debt, offset by the €249,658 (US\$310,000) debt securities financing.
- (iv) Amortization of deferred financing costs of €585 has been charged to interest expense.
- (v) A decrease in unrealized loss on interest rate derivatives of €307 and in unrealized and realized gain on foreign exchange rate derivatives of €18,642 to reflect derivatives settled on the refinancing of the Rosenthal debt. These derivatives and the Rosenthal debt will be settled and refinanced with partial proceeds from the issuance of our debt securities.
- (vi) A decrease in foreign exchange gain of €49,830 on the Celgar term facility to reflect the new financing inherent in the Acquisition. The Company will not be assuming such Celgar term facility pursuant to the Acquisition (Note 3).
- (vii) Reduced investment income of €513 to reflect the reduction of interest earned on restricted cash utilized in the refinancing of the Rosenthal debt.
- (viii) No tax expense has been recorded for items (i) thru (vii) above as the Company has sufficient tax loss carry-forwards available that could be utilized against taxes payable. The Company maintains a valuation reserve against the majority of these loss carry-forwards due to uncertainties regarding future taxable income.

Note 5. GAAP Differences

Celgar prepares its financial statements in accordance with Canadian GAAP and in Canadian dollars. The table below summarizes the conversion from Canadian GAAP and Canadian dollars to GAAP and the Euro. The GAAP adjustments are more fully disclosed in Note 10 of the unaudited financial statements of Celgar for the nine month period ended September 30, 2004 and 2003 and Note 12 of the audited financial statements of Celgar for the year ended December 31, 2003 in this prospectus supplement. The conversion from Canadian dollars to Euros has been reflected at the rates described in Note 1.

BALANCE SHEET OF STONE VENEPAL (CELGAR) PULP INC., IN BANKRUPTCY
September 30, 2004
(Unaudited)

(Expressed in thousands, unless otherwise stated)

	<u>Canadian GAAP</u>	<u>GAAP Adjustments</u>	<u>GAAP</u>	<u>GAAP</u>
Assets				
Current				
Accounts receivable	C\$ 27,551	C\$ 1,244	C\$ 28,795	€ 18,348
Inventories	76,136		76,136	48,513
Prepaid expenses and other	1,384		1,384	882
	<u>105,071</u>	<u>1,244</u>	<u>106,315</u>	<u>67,743</u>
Total current assets	105,071	1,244	106,315	67,743
Property, plant and equipment	252,613		252,613	160,963
Other assets		893	893	569
	<u>357,684</u>	<u>2,137</u>	<u>359,821</u>	<u>229,275</u>
Total assets	C\$ 357,684	C\$ 2,137	C\$ 359,821	€ 229,275
Liabilities				
Current				
Bank indebtedness	C\$ 20,662	C\$	C\$ 20,662	€ 13,166
Accounts payable and accrued liabilities	24,145		24,145	15,384
Current portion of obligation under capital leases	261		261	166
	<u>45,068</u>		<u>45,068</u>	<u>28,716</u>
Total current liabilities	45,068		45,068	28,716
Asset retirement obligation	965		965	615
Pre-bankruptcy and other debt	1,123,660	5,523	1,129,183	719,507
Obligation under capital leases	174		174	111
	<u>1,169,867</u>	<u>5,523</u>	<u>1,175,390</u>	<u>748,949</u>
Total liabilities	1,169,867	5,523	1,175,390	748,949
Shareholders' deficiency				
Share capital	17,800		17,800	11,342
Deficit	(829,983)	1,244	(828,739)	(528,066)
Accumulated other comprehensive income		(4,630)	(4,630)	(2,950)
	<u>(812,183)</u>	<u>(3,386)</u>	<u>(815,569)</u>	<u>(519,674)</u>
Total shareholders' deficiency	(812,183)	(3,386)	(815,569)	(519,674)
Total liabilities and shareholders' equity	C\$ 357,684	C\$ 2,137	C\$ 359,821	€ 229,275

STATEMENT OF OPERATIONS OF STONE VENEPAL (CELGAR) PULP INC., IN BANKRUPTCY
Nine months ended September 30, 2004
(Unaudited)

(Expressed in thousands, unless otherwise stated)

	<u>Canadian GAAP</u>	<u>GAAP Adjustments</u>	<u>GAAP</u>	<u>GAAP</u>
Net sales	C\$ 214,886	C\$	C\$ 214,886	€ 132,036
Operating expenses				
Cost of products sold	167,637		167,637	103,004
Depreciation and amortization	22,833		22,833	14,030
General and administrative	22,784		22,784	14,000
Impairment loss on property, plant and equipment	129,204		129,204	79,389
	<u>342,458</u>		<u>342,458</u>	<u>210,423</u>
Operating income	<u>(127,572)</u>		<u>(127,572)</u>	<u>(78,387)</u>
Other income (expense)				
Short-term interest expense	(474)		(474)	(291)
Interest expense on term credit facility	(34,019)		(34,019)	(20,903)
Unrealized gain (loss) on natural gas forward supply contracts		2,104	2,104	1,293
Foreign exchange gain on term credit facility	15,377		15,377	9,448
	<u>(19,116)</u>	<u>2,104</u>	<u>(17,012)</u>	<u>(10,453)</u>
Net earnings (loss) for the year	<u>C\$ (146,688)</u>	<u>C\$ 2,104</u>	<u>C\$ (144,584)</u>	<u>€ (88,840)</u>

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STATEMENT OF OPERATIONS OF STONE VENEPAL (CELGAR) PULP INC., IN BANKRUPTCY
Year ended December 31, 2003
(Unaudited)
(Expressed in thousands, unless otherwise stated)

	<u>Canadian GAAP</u>	<u>GAAP Adjustments</u>	<u>GAAP</u>	<u>GAAP</u>
Net sales	C\$ 271,566	C\$	C\$ 271,566	€ 171,169
Operating expenses				
Cost of products sold	230,555		230,555	145,320
Depreciation and amortization	39,225		39,225	24,724
General and administrative	38,069		38,069	23,995
	<u>307,849</u>		<u>307,849</u>	<u>194,039</u>
Operating loss	(36,283)		(36,283)	(22,870)
Other income (expense)				
Short-term interest expense	(512)		(512)	(323)
Interest expense on term credit facility	(47,579)		(47,579)	(29,989)
Unrealized gain (loss) on natural gas forward supply contracts		(1,055)	(1,055)	(665)
Foreign exchange gain on term credit facility	121,965		121,965	76,875
	<u>73,874</u>	<u>(1,055)</u>	<u>72,819</u>	<u>45,898</u>
Net earnings (loss) for the year	C\$ 37,591	C\$ (1,055)	C\$ 36,536	€ 23,028

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STATEMENT OF OPERATIONS OF STONE VENEPAL (CELGAR) PULP INC., IN BANKRUPTCY
Nine months ended September 30, 2003
(Unaudited)

(Expressed in thousands, unless otherwise stated)

	<u>Canadian GAAP</u>	<u>GAAP Adjustments</u>	<u>GAAP</u>	<u>GAAP</u>
Net sales	C\$ 207,593	C\$	C\$ 207,593	€ 130,545
Operating expenses				
Cost of products sold	182,903		182,903	115,019
Depreciation and amortization	29,320		29,320	18,438
General and administrative	28,220		28,220	17,746
	<u>240,443</u>		<u>240,443</u>	<u>151,203</u>
Loss from operations	<u>(32,850)</u>		<u>(32,850)</u>	<u>(20,658)</u>
Other income (expense)				
Short-term interest expense	(83)		(83)	(52)
Interest expense on term credit facility	(35,673)		(35,673)	(22,433)
Unrealized gain (loss) on natural gas forward supply contracts		(615)	(615)	(387)
Foreign exchange gain on term credit facility	97,772		97,772	61,484
	<u>62,016</u>	<u>(615)</u>	<u>61,401</u>	<u>38,612</u>
Net earnings (loss) for the year	<u>C\$ 29,166</u>	<u>C\$ (615)</u>	<u>C\$ 28,551</u>	<u>€ 17,954</u>

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Note 6. Restricted Group and Unrestricted Subsidiaries

The unaudited pro forma financial data below represents the financial results and condition of the restricted group of Mercer International Inc. and those of its subsidiaries that will be restricted subsidiaries under the indenture governing the notes. The restricted group is comprised of Mercer Inc., Rosenthal and Celgar. The unrestricted subsidiaries, comprised of Stendal and Dresden, will not be subject to the restrictive covenants of the indenture. This pro forma restricted group financial data excludes the effect of consolidation of the ownership and operation of the unrestricted subsidiaries. The unaudited pro forma condensed consolidated balance sheet of the restricted group includes the pro forma effect of the Financings, the Acquisition, related transactions and the payment of estimated fees and expenses and excludes the effect of consolidation of the ownership of the unrestricted subsidiaries. The unaudited pro forma condensed consolidated statements of operations of the restricted group gives effect to the Financings, the Acquisition, related transactions and the payment of estimated fees and expenses as if they occurred at the beginning of each period presented and eliminates the results of operations of the unrestricted subsidiaries that are not included in the consolidated restricted group. We have included this pro forma restricted group financial data because we believe the data provides investors with helpful information with respect to the financial results of the business and operations that will be subject to the restrictive covenants in the indenture governing the notes.

The pro forma restricted group financial data also reflects transactions between the restricted group and the unrestricted subsidiaries, such as sales of pulp by Rosenthal to Dresden and interest payments accruing from Stendal to Rosenthal. Mercer Inc., a member of the restricted group, has guaranteed five credit facilities, aggregating approximately €4.7 million, relating to the paper operations which are operated by an unrestricted subsidiary.

PRO FORMA CONDENSED CONSOLIDATED BALANCE SHEET (RESTRICTED GROUP)
September 30, 2004
(Unaudited)
(Expressed in thousands)

	Consolidated Pro Forma	Pro Forma Unrestricted Subsidiaries	Pro Forma Restricted Group
ASSETS			
Current			
Cash and cash equivalents	€ 41,310	€ 5,959	€ 35,351
Cash restricted	29,346	29,346	
Receivables	33,035	16,937	16,098
Unrealized foreign exchange derivative gains	479	479	
Inventories	80,295	44,969	35,326
Prepaid expenses	4,869	2,320	2,549
Total current assets	189,334	100,010	89,324
Cash restricted	19,074	19,074	
Property, plant and equipment	1,120,910	726,005	394,905
Other	25,589		21,596
Unrealized foreign exchange derivative gains	14,442	14,442	
Due from unrestricted group		4,189	43,139
Total assets	1,369,349	€ 863,720	548,964
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued expense	€ 65,766	€ 39,312	€ 26,454
Construction costs payable	160,952	160,952	
Note payable	1,403	1,403	
Debt, Stendal	50,000	50,000	
Debt, current portion	376	376	
Total current liabilities	278,497	252,043	26,454
Debt, Stendal	476,301	476,301	
Debt, less current portion	320,373	4,274	316,099
Due to restricted group		43,139	
Derivative financial instruments, construction in progress	58,874	58,874	
Other	20,421	6,600	13,821
Total liabilities	1,154,466	841,231	356,374
Shareholders' equity	214,883	22,489	192,590
Total liabilities and shareholders' equity	1,369,349	€ 863,720	548,964

The sum of the pro forma restricted group and unrestricted subsidiaries may not equal the pro forma consolidated amounts as intercompany transactions have been eliminated in the consolidated pro forma.

PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (RESTRICTED GROUP)
Nine Months Ended September 30, 2004
(Unaudited)
(Expressed in thousands, except per share data)

	Consolidated Pro Forma	Pro Forma Unrestricted Subsidiaries	Pro Forma Restricted Group
Revenues	€ 285,904	€ 42,255	€ 245,939
Cost of sales	245,579	42,913	204,876
Gross Profit	40,325	(658)	41,063
General and administrative	(34,584)	(10,605)	(23,979)
Impairment of capital assets	(6,000)	(6,000)	
Flooding grants, less losses and expenses	(669)	(669)	
Income (loss) from operations	(928)	(17,932)	17,084
Other income (expense)			
Interest expense	(20,901)	(3,413)	(22,521)
Investment income	556	(301)	1,881
Derivative financial instruments	491	(802)	1,293
Foreign exchange gain on term credit facility	1,791		1,791
Total other expense	(18,063)	(4,516)	(17,556)
Income (loss) before income taxes and minority interest	(18,991)	(22,448)	(472)
Income tax benefit	37		37
Income (loss) before minority interest	(18,954)	(22,448)	(435)
Minority interest	3,936	3,936	
Net income (loss)	(15,018)	(18,512)	(435)
Supplemental Disclosure:			
Depreciation and amortization	€ 26,150	€ 2,563	€ 23,587

The sum of the pro forma restricted group and unrestricted subsidiaries may not equal the pro forma consolidated amounts as intercompany transactions have been eliminated in the consolidated pro forma.

PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (RESTRICTED GROUP)

Year Ended December 31, 2003

(Unaudited)

(Expressed in thousands, except per share data)

	Consolidated Pro Forma	Pro Forma Unrestricted Subsidiaries	Pro Forma Restricted Group
Revenues	€ 365,725	€ 57,339	€ 310,721
Cost of sales	336,921	52,735	286,521
Gross Profit	28,804	4,604	24,200
General and administrative	(41,833)	(8,809)	(33,024)
Settlement expenses	(1,041)		(1,041)
Flooding grants, less losses and expenses	957	957	
Loss from operations	(13,113)	(3,248)	(9,865)
Other income (expense)			
Interest expense	(26,126)	(4,405)	(29,297)
Investment income	993	871	3,704
Derivative financial instruments	15,048	(12,299)	27,347
Impairment of equity method investment	(2,255)		(2,255)
Impairment of available-for-sale securities	(5,570)	(1,090)	(4,480)
Foreign exchange gain on term credit facility	14,571		14,571
Total other expense	(3,339)	(16,923)	9,590
Income (loss) before income taxes and minority interest	(16,452)	(20,171)	(275)
Income tax (provision) benefit	(3,172)		(3,172)
Loss before minority interest	(19,624)	(20,171)	(3,447)
Minority interest	5,647	5,647	
Net loss	(13,977)	€(14,524)	(3,447)
Supplemental Disclosure:			
Depreciation and amortization	€ 36,016	€ 2,031	€ 33,985

The sum of the pro forma restricted group and unrestricted subsidiaries may not equal the pro forma consolidated amounts as intercompany transactions have been eliminated in the consolidated pro forma.

PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (RESTRICTED GROUP)**Nine Months Ended September 30, 2003****(Unaudited)****(Expressed in thousands, except per share data)**

	Consolidated Pro Forma	Pro Forma Unrestricted Subsidiaries	Pro Forma Restricted Group
Revenues	€ 274,681	€ 43,313	€ 233,390
Cost of sales	258,178	39,126	221,231
Gross Profit	16,503	4,187	12,159
General and administrative	(29,472)	(5,473)	(23,999)
Settlement expenses	(630)		(630)
Flooding grants, less losses and expenses	1,162	1,162	
Loss from operations	(12,437)	(124)	(12,470)
Other income (expense)			
Interest expense	(18,118)	(3,297)	(21,781)
Investment income	542	(1)	3,666
Derivative financial instruments	(22,306)	(21,939)	(367)
Impairment of available-for-sale securities	(5,511)	(1,070)	(4,441)
Foreign exchange gain on term credit facility	11,654		11,654
Total other expense	(33,739)	(26,307)	(11,269)
Loss before income taxes and minority interest	(46,176)	(26,431)	(23,739)
Income tax (provision) benefit	(226)		(226)
Loss before minority interest	(46,402)	(26,431)	(23,965)
Minority interest	8,499	8,499	
Net loss	(37,903)	€(17,932)	(23,965)
Supplemental Disclosure:			
Depreciation and amortization	€ 27,068	€ 1,799	€ 25,269

The sum of the pro forma restricted group and unrestricted subsidiaries may not equal the pro forma consolidated amounts as intercompany transactions have been eliminated in the consolidated pro forma.

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As at December 31,

	2000	2001 ⁽¹⁾	2002 ⁽¹⁾	2003	As at September 30, 2004
					(unaudited)

(in thousands)

Balance Sheet Data:

Cash and cash equivalents	€ 19,689	€ 11,741	€ 30,261	€ 51,993	€ 42,643
Restricted cash	26,775	33,388	48,254	59,367 ⁽²⁾	76,884 ⁽²⁾
Working capital (deficit)	28,388	15,544	6,328	(48,947) ⁽³⁾	(122,474) ⁽³⁾
Total assets	429,724	429,593	599,750	935,905 ⁽⁴⁾	1,192,727
Debt, current portion, and note payable	29,822	25,752	17,138	17,178	16,868
Note payable, construction in progress ⁽⁵⁾			15,000		
Debt, Stendal, current portion				80,000	50,000
Debt, less current portion ⁽⁶⁾	221,772	216,871	205,393	255,901	234,317
Debt, Stendal, less current portion ⁽⁵⁾			146,485	324,238	476,301
Shareholders' equity	133,497	131,613	124,969	132,855	121,595

Year Ended December 31,

Nine Months Ended
September 30,

	2000	2001 ⁽¹⁾	2002 ⁽¹⁾	2003	2003	2004
						(unaudited)

(in thousands, except for ratio and ADMT data)

Other Data:

Net cash from (used in) operating activities	€ 43,395	€ 30,364	€ 40,446	€ 31,440	€ 6,969	€ (1,185)
Capital expenditures ⁽⁷⁾	€ 27,028	€ 10,097	€ 13,800	€ 14,647	€ 9,485	€ 6,611
Operating EBITDA ⁽⁸⁾	€ 73,711	€ 36,298	€ 24,469	€ 19,564	€ 15,616	€ 15,592
Ratio of earnings to fixed charges ⁽⁹⁾	3.11	0.83 ⁽¹⁰⁾	⁽¹⁰⁾	0.32 ⁽¹⁰⁾	⁽¹⁰⁾	⁽¹⁰⁾

Rosenthal Mill Operating Data⁽¹¹⁾:

Sales volume (ADMTs) ⁽¹²⁾	239,552	285,654	293,607	303,655	221,926	229,462
Productivity (ADMTs produced per day)	736	858	887	898	893	914
Average price realized (per ADMT) ⁽¹²⁾	€ 667	€ 512	€ 443	€ 417	€ 416	€ 452
Cash production costs (per ADMT produced) ⁽¹³⁾	€ 353	€ 342	€ 312	€ 307	€ 310	€ 300
Income (loss) from operations	€ 49,594	€ 18,610	€ 3,421	€ 1,931	€ (22)	€ 13,004
Depreciation and amortization ⁽¹⁴⁾	€ 20,481	€ 21,422	€ 21,567	€ 21,881	€ 16,311	€ 14,166
Capital expenditures	€ 23,766	€ 7,416	€ 8,426	€ 6,869	€ 3,459	€ 2,924

(1)

In December 2001, we acquired Landqart, which operates a specialty paper mill, for approximately \$2.7 million. Results from the Landqart mill are not included in our results for 2001, but are included for 2002. The Landqart mill sold approximately 18,222 ADMTs for €39.7 million in the year ended December 31, 2002. At the end of 2002, we transferred 20% of our interest in Landqart to a Swiss bank and exchanged our remaining 80% interest for an indirect 39% minority interest through a limited partnership on a non-cash basis. As of December 31, 2002, our interest in the Landqart mill was no longer consolidated and is included in our financial results on an equity basis.

(2)

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As at December 31, 2003, this amount is comprised of €15.2 million for payment of construction in progress costs payable and €19.1 million in a debt service account, relating to construction in progress at the site of the Stendal mill, as well as €25.1 million in a debt service account relating to the Rosenthal mill. As at September 30, 2004, this amount is comprised of €29.3 million for payment of construction costs payable and €19.1 million in a debt service account, both relating to the Stendal project, as well as €28.5 million in a debt service account related to the Rosenthal mill.

(3)

We had a working capital deficit of €48.9 million and €122.5 million at December 31, 2003 and September 30, 2004, respectively, primarily because we had Stendal construction costs payable of €42.8 million and €161.0 million at December 31, 2003 and September 30, 2004, respectively, for which we had not yet drawn down under the Stendal project finance facility and, under our accounting policies, we do not record certain government grants until they are received. The Stendal construction costs will be paid pursuant to the Stendal

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project finance facility in the ordinary course. At September 30, 2004, we qualified for additional investment grants related to the Stendal mill totaling approximately €65.2 million from the federal and state governments of Germany, which we expect to receive in 2005. Approximately €61.2 million of these grants, when received, will be applied to repay the amounts drawn under the dedicated tranche of the Stendal project finance facility. The grants are not reported in our income and reduce the cost basis of the assets purchased when they are received. We expect to qualify for additional investment grants totaling €23.3 million when such Stendal construction costs have been substantially paid.

- (4) Includes approximately €503.2 million as at December 31, 2003 related to properties construction in progress at the site of the Stendal mill.
- (5) Construction of the Stendal mill commenced in August 2002 and was completed substantially on its planned schedule and budget in the third quarter of 2004. As a result, as at September 30, 2004, liabilities relating to the construction of the Stendal mill were no longer classified as construction in progress.
- (6) As at September 30, 2004, this includes €66.4 million aggregate principal amount of 8.5% convertible senior subordinated notes due October 2010, convertible at any time by the holder into our shares of beneficial interest at \$7.75 per share.
- (7) Excluding capital expenditures of approximately €186.9 million, €399.4 million, €284.1 million and €235.1 million during the years ended December 31, 2002 and 2003 and the nine months ended September 30, 2003 and 2004, respectively, relating to the Stendal project.
- (8) Net Income (Loss) to Operating EBITDA Reconciliation:

	Year Ended December 31,				Nine Months Ended September 30,	
	2000	2001	2002	2003	2003	2004
	(unaudited)					
	(in thousands)					
Net income (loss)	€ 32,013	€ (2,823)	€ (6,322)	€ (3,593)	€ (9,173)	€ (12,604)
Minority interest			(10,965)	(5,647)	(8,499)	(3,936)
Income taxes	117	83	(264)	3,172	226	(37)
Interest expense	15,198	16,170	13,753	11,523	6,887	9,554
Investment income	2,337	(2,872)	(436)	(1,653)	(1,055)	(1,679)
Derivative financial instruments		2,504	6,679	(16,168)	3,604	1,077
Impairment of investments				7,825	5,511	
Other		270	(3,590)		(20)	
	49,665	13,332	(1,145)	(4,541)	(2,519)	(7,625)
Income (loss) from operations						
Add: Depreciation and amortization	24,046	22,966	25,614	24,105	18,135	17,217
Impairment charge						6,000
Operating EBITDA	€ 73,711	€ 36,298	€ 24,469	€ 19,564	€ 15,616	€ 15,592

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In connection with Mercer's results for the third quarter of 2004, our management determined to record and our audit committee approved a non-cash impairment charge of €6.0 million to write-off the carrying value of our Fährbrücke paper mill assets. We determined to take the impairment charge as the Fährbrücke mill has generated weaker than expected returns over a period of time despite changes to its product mix. We do not expect the impairment charge in and of itself to result in future cash expenditures as we intend to continue to operate the Fährbrücke mill.

We define Operating EBITDA for this purpose as income from operations plus depreciation and amortization and non-recurring capital asset impairment charges. Management uses Operating EBITDA as a benchmark measurement of its own operating results and as a benchmark relative to its competitors. Management considers it to be a meaningful supplement to operating income as a performance measure primarily because depreciation expense is not an actual cash cost and varies widely from company to company in a manner that management considers largely independent of the underlying cost efficiency of their operating facilities. In addition, we believe it is commonly used by securities analysts, investors and other interested parties to

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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. Management also believes Operating EBITDA facilitates operating performance comparisons from period to period by backing out the significant impact caused by our derivative instruments which are marked to market for each reporting period or settled. 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 from operations as a measure of performance, nor as an alternative to net cash from operating activities as a measure of liquidity. Operating EBITDA has significant limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our results as reported under GAAP. Because of these limitations, Operating EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business. See the Statements of Cash Flows included in our consolidated financial statements included elsewhere in this prospectus supplement. Because all companies do not calculate Operating EBITDA in the same manner, Operating EBITDA as calculated by us may differ from Operating EBITDA as calculated by other companies.

- (9) For purposes of computing the ratio of earnings to fixed charges, earnings consist of income before income taxes, minority interest, income (loss) from equity investee and fixed charges. Fixed charges consist of interest expense plus capitalized interest.
- (10) For the years ended December 31, 2001, 2002 and 2003, our deficiency of earnings to fixed charges was €2.7 million, €20.7 million, €19.5 million, respectively. For the nine months ended September 30, 2003 and 2004, our deficiency of earnings to fixed charges was €29.0 million and €43.2 million, respectively. On a pro forma basis for the year ended December 31, 2003, and nine months ended September 30, 2003 and 2004, the deficiency of earnings to fixed charges was €29.9 million, €57.8 million and €45.7 million, respectively.
- (11) Construction of the Stendal mill was completed in the third quarter of 2004. Although the Stendal mill had approximately 13 days of operations in September 2004, it is currently in the start-up phase. As a result, management believes that the operating data relating to the Stendal mill during the third quarter of 2004 would not provide an accurate representation of the mill's actual operating performance in the future. Accordingly, we have provided only the operating data relating to the Rosenthal mill.
- (12) For external sales only.
- (13) Cost of production per ADMT produced excluding depreciation. Total cash production costs for the nine months ended September 30, 2003 and 2004 may not be comparable on an annualized basis due to the timing of maintenance expenditures.
- (14) The Stendal pulp mill was substantially complete and ready for its intended use on September 18, 2004. Effective September 18, 2004, we began expensing all of the costs, including interest, related to the Stendal mill and began depreciating it. A depreciation period of 25 years was established based on the expected useful life of the production assets. Depreciation was computed using the straight-line method in accordance with our accounting policies. In conjunction with establishing the depreciation period for the Stendal mill, we also reviewed the useful life of the Rosenthal mill, which resulted in a change in the estimate of its useful life from an initial 15 to 25 years. The change in estimate was reflected effective July 1, 2004. As the Rosenthal mill had been depreciated for approximately 5 years as of July 1, 2004, the change in estimate reflects a remaining depreciable life of approximately 20 years. The total effect of the change in estimate resulted in a decrease of approximately €2.2 million in depreciation, cost of sales and net loss, and a decrease in basic and diluted net loss per share of €0.13 for the nine months ended September 30, 2004.

SELECTED HISTORICAL FINANCIAL INFORMATION OF CELGAR

The following tables set forth selected historical financial and operating data of Celgar as at and for the periods indicated. The following selected financial and operating data is qualified in its entirety by, and should be read in conjunction with, the financial statements and related notes of Celgar included elsewhere in this prospectus supplement.

The selected historical financial and operating data of Celgar as at and for the three years ended December 31, 2003 presented below has been derived from Celgar's audited financial statements. The selected historical financial and operating data of Celgar as at and for the nine months ended September 30, 2004 and 2003 and the year ended December 31, 2000 presented below has been derived from Celgar's unaudited financial statements. It should be noted that the results of operations for any interim period are not necessarily indicative of the results of operations for the entire fiscal year.

Please note that the selected historical financial and operating data of Celgar presented below and the financial statements for Celgar included in this prospectus supplement reflect the entire assets, liabilities and operations of Celgar for the periods and as at the dates indicated. However, we are only acquiring substantially all of the operating assets of Celgar which, pursuant to the terms of the Acquisition Agreement, do not include the finished goods inventory and receivables of Celgar. Further, we are not assuming certain liabilities of Celgar including indebtedness for borrowed money for pre-and post-bankruptcy periods which aggregated approximately C\$1.1 billion at December 31, 2003 and September 30, 2004, respectively. Accordingly, we are only providing selected balance sheet data for Celgar. See "The Acquisition" for more information.

Celgar prepares its financial statements in accordance with Canadian GAAP, which differs in certain respects from GAAP. For a discussion of the differences between Canadian GAAP and GAAP as they pertain to Celgar, see Note 10 of the unaudited financial statements of Celgar for the nine month period ended September 30, 2004 and 2003 and Note 12 of the audited financial statements of Celgar for the year ended December 31, 2003 included elsewhere in this prospectus supplement.

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	Year Ended December 31,				Nine Months Ended September 30,	
	2000 ⁽¹⁾	2001 ⁽²⁾	2002	2003	2003	2004
	(unaudited)				(unaudited)	

(in thousands, except for ADMT data)

Statement of Operations

Data:

Sales	C\$ 363,570	C\$ 246,139	C\$ 249,366	C\$ 271,566	C\$ 207,593	C\$ 214,886
Operating expenses:						
Costs of sales	C\$ 231,494	C\$ 239,938	C\$ 213,602	C\$ 230,555	C\$ 182,903	C\$ 167,637
Depreciation and amortization	C\$ 38,807	C\$ 38,966	C\$ 38,932	C\$ 39,225	C\$ 29,320	C\$ 22,833
General and administrative	C\$ 29,045	C\$ 25,877	C\$ 30,642	C\$ 38,069	C\$ 28,220	C\$ 22,784
Impairment loss on property, plant and equipment						C\$ 129,204 ⁽³⁾
Income (loss) from operations ⁽⁴⁾	C\$ 64,224	C\$ (58,642)	C\$ (33,810)	C\$ (36,283)	C\$ (32,850)	C\$ (127,572) ⁽³⁾

Balance Sheet Data:

Working capital	C\$ 82,268	C\$ 55,424	C\$ 56,058	C\$ 52,456	C\$ 48,081	C\$ 60,003
Property, plant and equipment	C\$ 503,029	C\$ 470,326	C\$ 436,542	C\$ 402,633	C\$ 411,206	C\$ 252,613 ⁽³⁾

Other Data:

Net cash from operating activities	C\$ 84,648	C\$ (7,401)	C\$ 8,085	C\$ 13,232	C\$ 10,199	C\$ 706
Capital expenditures	C\$ 3,579	C\$ 6,262	C\$ 3,912	C\$ 5,201	C\$ 3,985	C\$ 2,017
Operating EBITDA ⁽⁴⁾⁽⁵⁾	C\$ 103,031	C\$ (19,676)	C\$ 5,122	C\$ 2,942	C\$ (3,530)	C\$ 24,465

Operating Data:

Sales volume (ADMTs)	379,377	365,133	400,101	427,860	329,253	292,233
Productivity (ADMTs produced per day)	1,172	1,198	1,155	1,202	1,181	1,209
Average price realized (per ADMT)	C\$ 958	C\$ 674	C\$ 623	C\$ 635	C\$ 630	C\$ 735
Cash production costs (per ADMT produced) ⁽⁶⁾	C\$ 565	C\$ 571	C\$ 491	C\$ 499	C\$ 513	C\$ 533

- (1) In connection with Celgar's results for 2000, audited financial statements were prepared for the twelve month period ended March 31, 2000 and for the nine month period ended December 31, 2000. Audited financial statements for the twelve month period ended December 31, 2000 were not prepared and, as a result, the selected financial information presented for 2000 is based on unaudited financial statements prepared for such period.
- (2) The Celgar mill was shut down for approximately 50 days in 2001 for market related reasons.
- (3) As at and for the nine month period ended September 30, 2004, Celgar recorded an impairment charge of C\$129.2 million to write-down the carrying value of its property, plant and equipment to the fair value of the assets as a result of the Acquisition.
- (4) "Income (loss) from operations" and "Operating EBITDA" include costs (benefits) relating to a burner misalignment in the lime kiln at the Celgar mill, for which the vendor of the Celgar mill has an insurance claim outstanding, foreign exchange losses (gains) on current receivables and payables and fees paid to KPMG Inc., as receiver and trustee in bankruptcy of Celgar as follows:

	Year Ended December 31,				Nine Months Ended September 30,	
	2000	2001	2002	2003	2003	2004
	(unaudited)				(unaudited)	
	(in thousands)					
Lime kiln costs				C\$ 3,136	C\$ 2,036	C\$ 96
Foreign exchange losses (gains)	C\$ (1,333)	C\$ (1,769)	C\$ 792	C\$ 5,965	C\$ 4,952	C\$ 921
Receiver and trustee costs	C\$ 1,965	C\$ 2,025	C\$ 1,812	C\$ 1,899	C\$ 1,747	C\$ 772

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See "Management's Discussion and Analysis of Financial Condition and Results of Operations of Celgar".

(5)

Income (Loss) from Operations to Operating EBITDA Reconciliation:

	Year Ended December 31,				Nine Months Ended September 30,	
	2000	2001	2002	2003	2003	2004
	(unaudited)				(unaudited)	
	(in thousands)					
Income (loss) from operations	C\$ 64,224	C\$ (58,642)	C\$ (33,810)	C\$ (36,283)	C\$ (32,850)	C\$ (127,572)
Add: Depreciation and amortization	C\$ 38,807	C\$ 38,966	C\$ 38,932	C\$ 39,225	C\$ 29,320	C\$ 22,833
Impairment loss on property, plant and equipment						C\$ 129,204
Operating EBITDA	C\$ 103,031	C\$ (19,676)	C\$ 5,122	C\$ 2,942	C\$ (3,530)	C\$ 24,465

Mercer is presenting Operating EBITDA for Celgar for comparative purposes only. Operating EBITDA for Celgar has not been reconciled to net income (loss) as Mercer is acquiring substantially all of the assets of Celgar and will not be assuming certain liabilities of Celgar, including indebtedness for borrowed money for pre- and post-bankruptcy periods. Operating EBITDA is defined as income (loss) from operations plus depreciation and amortization and non-recurring capital asset impairment charges.

(6)

Cost of production per ADMT produced excluding depreciation. Total cash production costs for the nine months ended September 30, 2003 and 2004 may not be comparable on an annualized basis due to the timing of maintenance expenditures.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS OF MERCER**

For the purposes of this Management's Discussion and Analysis of Financial Condition and Results of Operations of Mercer, all references to "we", "our", "us", the "Company" or "Mercer" mean Mercer International Inc. and its subsidiaries without giving effect to the Acquisition.

The following discussion and analysis of our financial condition and results of operations as at and for the nine months ended September 30, 2003 and 2004 and the three years ended December 31, 2003 should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this prospectus supplement. Effective January 1, 2002, we changed our reporting currency from the U.S. dollar to the Euro. Accordingly, our financial statements as at and for the nine months ended September 30, 2003 and 2004 and the years ended December 31, 2002 and 2003 included in this prospectus supplement are stated in Euros and our financial statements for periods prior to the year ended December 31, 2002 included in this prospectus supplement have been restated in Euros and reclassified to conform to the current presentation. The following management discussion and analysis of our financial condition and results of operations is based upon the restated financial statements for all periods.

Results of Operations

We operate in the pulp and paper business and our operations are located primarily in Germany. Our manufacturing facilities are comprised of: (a) an NBSK pulp mill operated by our wholly-owned subsidiary, Rosenthal, near Blankenstein, Germany, which has an annual production capacity of approximately 310,000 ADMTs; (b) a newly constructed, state-of-the-art NBSK pulp mill, with a design production capacity of approximately 552,000 ADMTs per year, near Stendal, Germany built and being started up by our 63.6% owned subsidiary, Stendal; and (c) two paper mills located at Heidenau and Fährbrücke, Germany, which produce specialty papers and printing and writing papers and, based upon their current product mix, have an aggregate annual production capacity of approximately 70,000 ADMTs.

The Stendal mill was completed substantially on its planned schedule and budget in the third quarter of 2004. Total investment costs in respect of the Stendal mill are approximately €1.0 billion, the majority of which was financed under a senior project finance facility, referred to as the "Stendal Loan Facility", in the amount of €828 million and arranged with Bayerische Hypo-und Vereinsbank AG, referred to as "HVB". The Stendal mill is currently in the start-up phase and underwent extensive testing and evaluation in December 2004. Samples of the pulp produced during such testing have been sent to laboratories for qualitative testing and the results are expected to be received by mid-January 2005. The mill substantially passed all of the quantitative tests, although the test was extended due to an operator error relating to the recovery boiler. See "Business Stendal Pulp Mill Project and Financing". Effective September 18, 2004, we commenced expensing all of the costs, including interest, related to the Stendal mill. Prior to that date, most of the costs, including interest, relating to the Stendal mill were capitalized. Our results for the nine months ended September 30, 2004 include operating and interest costs of €9.8 million related to the Stendal mill. During such period, we did not report any pulp sales revenues from Stendal. Some lower quality pulp produced at the Stendal mill prior to September 18, 2004 was sold, but the revenues therefrom were capitalized against testing costs in property, plant and equipment.

Our financial performance depends on a number of variables that impact sales and production costs. Sales and production results are influenced largely by the market price for products and raw materials, the mix of products produced and foreign currency exchange rates. Kraft pulp and paper markets are highly cyclical, with prices determined by supply and demand. Demand for kraft pulp and paper is influenced to a significant degree by global levels of economic activity and supply is driven by

industry capacity and utilization rates. Our product mix is important because premium grades of kraft pulp and specialty papers generally achieve higher prices and profit margins.

Our production costs are influenced by the availability and cost of raw materials, energy and labor, and our plant efficiencies and productivity. Our main raw material is fiber in the form of wood chips and pulp logs for pulp production, and waste paper and pulp for paper production. Wood chip and pulp log costs are primarily affected by the supply of, and demand for, lumber and pulp, which are both highly cyclical. Production costs also depend on the total volume of production. High operating rates and production efficiencies permit us to lower our average cost by spreading fixed costs over more units.

Global economic conditions, changes in production capacity and inventory levels are the primary factors affecting kraft pulp and paper prices. Historically kraft pulp and paper prices have been cyclical in nature. The average annual European list prices for NBSK pulp between 1990 and 2003 ranged from a low of \$444 per ADMT in 1993 to a high of \$875 per ADMT in 1995. Following a decline in demand in 2001, list prices for NBSK pulp also declined and averaged approximately \$463 per ADMT in 2002. An increase in demand resulting from improving American and major European economies and the weakening of the U.S. dollar against the Euro and other major currencies in 2003 resulted in list prices for kraft pulp in Europe increasing to approximately \$560 per ADMT in December 2003 despite relatively high inventory levels. List prices for kraft pulp in Europe continued to strengthen in 2004 due to the relatively weak U.S. dollar and improving world economies. List prices increased to approximately \$660 per ADMT in July 2004, before falling to approximately \$585 per ADMT in October 2004 and subsequently recovering to approximately \$625 per ADMT in December 2004. A producer's sales realizations will reflect customer discounts, commissions and other items and it is likely that NBSK pulp prices will continue to fluctuate in the future.

Our financial performance for any reporting period is also impacted by changes in the U.S. dollar to Euro exchange rate and in interest rates. Changes in currency rates affect our operating results because the price for our principal product, NBSK pulp, is generally based on a global industry benchmark that is quoted in U.S. dollars, even though our sales are invoiced in Euros. Therefore, a weakening of the U.S. dollar against the Euro will generally reduce the amount of Euro revenues of our pulp operations. Most of our costs, including our debt obligations, are incurred in Euros. These do not fluctuate with the U.S. dollar to Euro exchange rate. Thus, a weakening of the U.S. dollar against the Euro tends to reduce our sales revenue, gross profit and income from operations. The continuing deterioration of the U.S. dollar against the Euro in the fourth quarter of 2004 will adversely affect our operating performance for the quarter, which we currently anticipate would be largely offset by realized gains on our hedging transactions.

Changes in interest rates can impact our operating results because the indebtedness we incurred under the credit facilities for establishing the Rosenthal and Stendal pulp mills provide for floating rates of interest.

Changes in currency exchange and interest rates also impact certain foreign currency and interest rate derivatives Rosenthal and Stendal use to partially protect against the effect of such changes. Gains or losses on such derivatives are included in our earnings, either as they are settled or as they are marked to market for each reporting period. See " Quantitative and Qualitative Disclosures about Market Risk".

Stendal, as required under its project financing, entered into variable-to-fixed rate interest swaps, referred to as the "Stendal Interest Rate Swaps", in August 2002 to fix the interest rate on approximately €612.6 million of indebtedness for the full term of the Stendal Loan Facility. Rosenthal has also entered into forward interest rate and interest cap contracts, referred to as the "Rosenthal Interest Rate Contracts" and, together with the Stendal Interest Rate Swaps, the "Interest Rate

Contracts", in respect of a portion of its long-term indebtedness under its bank loan facility, referred to as the "Rosenthal Loan Facility".

In the nine months ended September 30, 2004 and year ended December 31, 2003, we recorded a net non-cash holding loss of €15.8 million and €13.1 million, respectively, before minority interests on the marked to market valuation of the Interest Rate Contracts versus a net loss of €22.8 million and €32.4 million before minority interests thereon in the nine months ended September 30, 2003 and year ended December 31, 2002, respectively.

In March 2004, to protect against a weakening U.S. dollar, Rosenthal entered into two currency swaps in the aggregate principal amount of €184.5 million to convert all of its long-term indebtedness under the Rosenthal Loan Facility into U.S. dollars and a currency forward in the notional amount of €40.7 million, referred to as the "Rosenthal Currency Derivatives". In the same month, Stendal entered into a currency swap in the principal amount of €306.3 million to convert approximately one-half of its indebtedness under the Stendal Loan Facility into U.S. dollars and a currency forward in the notional amount of €20.6 million, referred to as the "Stendal Currency Derivatives" and, together with the Rosenthal Currency Derivatives, the "Currency Derivatives". Primarily as a result of a weakening of the U.S. dollar versus the Euro and changes in interest rates related to such currencies, in the nine months ended September 30, 2004, we recognized a net non-cash holding gain of approximately €14.7 million before minority interests on the Currency Derivatives. In the nine months ended September 30, 2003, we recognized a net gain of approximately €19.2 million before minority interests on the then outstanding currency derivatives of Rosenthal and Stendal. In the year ended December 31, 2003, we recognized a gain of €29.3 million before minority interests on the then outstanding currency derivatives of Rosenthal and Stendal, compared to a net gain of €25.7 million before minority interests in 2002 on the then outstanding currency derivatives of Rosenthal. Stendal did not have any currency derivatives outstanding in the year ended December 31, 2002. See " Quantitative and Qualitative Disclosures about Market Risk".

In December 2004, we settled the Currency Derivatives due to the substantial weakening of the U.S. dollar versus the Euro in 2004. We realized a gain of approximately €44.5 million upon the settlement of these derivatives, €14.7 million of which we had already booked as an unrealized gain as at September 30, 2004. We expect to enter into similar derivatives in the future and could record realized or unrealized marked to market non-cash holding gains or losses on such derivatives in the future.

Improving world economies resulted in an increase in interest rates in the first half of 2004. If world economies continue to strengthen, we would expect interest rates to continue to rise from their historically low levels. Higher interest rates could result in our recording marked to market non-cash holding gains on the Interest Rate Contracts in future periods, which may be offset in part by higher interest rates payable on Rosenthal's debt obligations. However, a fall in interest rates could result in our recording non-cash holding losses on the Interest Rate Contracts in future periods when they are marked to market. See " Quantitative and Qualitative Disclosures about Market Risk".

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Selected sales data for each of our last three years and the nine months ended September 30, 2003 and 2004 is as follows:

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
	(ADMTs)				
Sales Volume by Product Class					
Pulp ⁽¹⁾	285,654	293,607	303,655	221,926	229,462
Papers					
Specialty papers	40,437 ⁽²⁾	61,727 ⁽²⁾	40,621	30,420	28,144
Printing papers	26,815	23,195	21,397	16,568	19,357
	67,252	84,922	62,018	46,988	47,501
Total⁽¹⁾	352,906	378,529	365,673	268,914	276,963

(in thousands)

Revenues by Product Class					
Pulp ⁽¹⁾	€ 146,245	€ 130,173	€ 126,594	€ 92,418	€ 103,743
Papers					
Specialty papers	35,959 ⁽²⁾	79,358 ⁽²⁾	40,082	30,185	28,039
Printing papers	22,797	18,352	15,780	12,332	13,302
	58,756	97,710	55,862	42,517	41,341
Total⁽¹⁾	€ 205,001	€ 227,883	€ 182,456	€ 134,935	€ 145,084

(1) Excluding intercompany sales volumes of 10,447, 10,768 and 5,527 ADMTs of pulp and intercompany net sales revenues of approximately €5.8 million, €4.9 million and €2.3 million in 2001, 2002 and 2003, respectively, and intercompany sales volumes of 5,166 and 3,897 ADMTs of pulp and intercompany net sales revenues of approximately €2.2 million and €1.8 million in the nine months ended September 30, 2003 and 2004, respectively.

(2) We acquired Landqart, which operates a specialty paper mill, in December 2001 for approximately \$2.7 million. As of December 31, 2002, our interest in Landqart is no longer consolidated and is included in our financial results on an equity basis. Accordingly, sales from the Landqart specialty paper mill are not included in our results for 2001, but are included for 2002. The Landqart mill sold approximately 18,222 ADMTs for approximately €39.7 million in 2002.

Acquisition of the Celgar Mill

On November 22, 2004, we entered into the Acquisition Agreement to acquire substantially all of the assets of Celgar. The purchase price of the Acquisition is \$210 million (subject to certain adjustments and excluding fees and expenses), of which \$170 million is payable in cash and \$40 million is payable in our shares, plus an amount for the defined working capital of the Celgar mill on closing of the Acquisition. The cash portion of the purchase price and the working capital amount is to be paid in part from the proceeds of the Share Offering and the balance is to be paid from this offering. See "The Financings" and "The Acquisition".

The Celgar mill is a modern NBSK pulp mill that produces high quality NBSK pulp. It has a current annual production capacity of approximately 430,000 ADMTs, and is located near the city of Castlegar, British Columbia, Canada. In the early 1990's, it was completely

rebuilt through a C\$850 million modernization and expansion project. See "Business" for more information relating to the Celgar mill.

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Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003 (Unaudited)

Total revenues for the nine months ended September 30, 2004 increased to €153.9 million from €144.1 million in the comparative period of 2003, primarily because of higher pulp sales. Pulp and paper revenues were €145.1 million in the current period, versus €134.9 million in the comparative period of 2003.

Costs of pulp and paper sales in the nine months ended September 30, 2004 decreased to €131.4 million from €131.8 million in the comparative period of 2003, primarily as a result of lower pulp production costs at our Rosenthal mill.

In the current period, pulp sales increased to €103.7 million from €92.4 million in the same period a year ago as a result of higher prices and production from our Rosenthal mill. We did not report any revenues from the sale of pulp from the Stendal mill in either period. List prices for NBSK pulp in Europe were approximately €519 (\$635) per ADMT in the third quarter of 2004, compared to approximately €444 (\$550) per ADMT in the third quarter of last year. The increase in NBSK pulp prices was partially offset by the weakness of the U.S. dollar versus the Euro in the current period. In the current period, pulp sales by volume were 229,462 ADMTs, compared to 221,926 ADMTs in the comparative period of 2003.

Pulp sales realizations were €452 per ADMT on average in the current period, compared to €416 per ADMT in the comparative period of 2003.

Transportation and other revenues for the pulp operations were €8.9 million in the period ended September 30, 2004, compared to €8.2 million in the comparative period of last year.

Cost of sales and general, administrative and other expenses for the pulp operations increased to €108.8 million in the nine months ended September 30, 2004 from €104.6 million in the comparative period of 2003, primarily as a result of the inclusion of €7.9 million of operating costs related to the Stendal mill.

On average, fiber costs for pulp production decreased by approximately 4.3% compared to the first nine months of last year.

Depreciation for the pulp operations was €15.0 million in the current period, versus €16.3 million in the year ago period. A change effective July 1, 2004 in our depreciation estimate in respect of our Rosenthal mill resulted in a decrease of €2.2 million in cost of sales and net loss, and a decrease in net loss per share of €0.13 for the nine months ended September 30, 2004.

For the nine months of 2004, our pulp operations generated operating income of €5.7 million, versus an operating loss of €1.8 million in the year ago period.

Paper sales in the current period were €41.3 million, compared with €42.5 million in the same period of last year. Sales of specialty papers in the nine months ended September 30, 2004 were €28.0 million versus €30.2 million in the comparative period of 2003, primarily as a result of a shift in the product mix. For the current period, total paper sales volumes were 47,501 ADMTs, versus 46,988 ADMTs in the nine months ended September 30, 2003. On average, prices for specialty papers realized in the current period increased slightly, reflecting a shift in the product mix. Average prices for our printing papers decreased by approximately 7.7% reflecting generally weak demand.

Cost of sales and general, administrative and other expenses for the paper operations in the nine months ended September 30, 2004 increased to €52.2 million from €41.7 million in the comparative period of 2003, primarily as a result of a non-cash €6.0 million impairment charge relating to our paper operations. On November 3, 2004, our management determined to record and our audit committee approved a non-cash impairment charge of €6.0 million to write-off the carrying value of our Fährbrücke paper mill assets. Based upon its current product mix, the mill has an annual production

capacity of approximately 35,000 ADMTs and produces primarily printing and writing paper. We determined to take the impairment charge as the Fährbrücke mill has generated weaker than expected returns over a period of time despite changes to its product mix. We do not expect the impairment charge in and of itself to result in future cash expenditures as we intend to continue to operate the Fährbrücke mill.

Depreciation for the paper operations was €1.7 million in the current period, compared to €1.5 million in the same period last year.

For the nine months ended September 30, 2004, our paper operations generated an operating loss of €10.6 million, which included the non-cash impairment charge of €6.0 million, compared to operating income of €1.6 million in the same period of last year.

In the current period, we reported a loss from operations of €7.6 million, compared to €2.5 million in the same period last year. Interest expense (excluding capitalized interest of €27.2 million relating to the Stendal pulp mill) in the period ended September 30, 2004 increased to €9.6 million from €6.9 million a year ago, due to higher borrowings resulting primarily from our convertible note issue in October 2003 and the inclusion of interest expense of €1.9 million relating to the Stendal project after September 18, 2004.

In the period ended September 30, 2004, we recorded a net non-cash holding loss of €15.8 million before minority interests on the marked to market valuation of the Interest Rate Contracts versus a net loss of €22.8 million before minority interests thereon in the prior period of 2003. In addition, in the nine months ended September 30, 2004, we recorded a net non-cash holding gain of approximately €14.7 million before minority interests on the valuation of the Currency Derivatives as a result of the weakening of the U.S. dollar versus the Euro and changes in interest rates related to such currencies. In the prior period of 2003, we recorded a net gain of €19.2 million before minority interests on the then outstanding currency derivatives of Rosenthal and Stendal.

In the nine months ended September 30, 2004, minority interest, representing the two minority shareholders' proportionate interest in the Stendal project, was €3.9 million, compared to €8.5 million in the comparative period of 2003.

Our results for the prior period of 2003 included an adjustment of €5.5 million for the non-cash impact of other-than-temporary impairment losses on our available-for-sale securities.

We reported a net loss for the nine months ended September 30, 2004 of €12.6 million, or €0.73 per basic and diluted share, which reflected the non-cash €6.0 million impairment charge related to our paper operations, the inclusion of €9.8 million of operating and interest costs related to our Stendal mill and the net non-cash holding loss on the marked to market valuation of our derivative instruments. In the comparative period of 2003, we reported a net loss of €9.2 million, or €0.54 per basic and diluted share.

We generated "Operating EBITDA" of €15.6 million in the nine months ended September 30, 2004 and 2003, respectively. Operating EBITDA is defined as income (loss) from operations plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA is calculated by adding depreciation and amortization and non-recurring capital asset impairment charges of €23.2 million and €18.1 million to the loss from operations of €7.6 million and €2.5 million for the nine-month periods ended September 30, 2004 and 2003, respectively.

Management uses Operating EBITDA as a benchmark measurement of its own operating results, and as a benchmark relative to its competitors. Management considers it to be a meaningful supplement to operating income as a performance measure primarily because depreciation expense and non-recurring capital asset impairment charges are not an actual cash cost, and depreciation expense varies widely from company to company in a manner that management considers largely independent

of the underlying cost efficiency of their operating facilities. In addition, we believe Operating EBITDA is commonly used by securities analysts, investors and other interested parties to evaluate our financial performance.

Operating EBITDA does not reflect the impact of a number of items that affect our net income (loss), 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, nor as an alternative to net cash from operating activities as a measure of liquidity.

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

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

	Nine Months Ended September 30,	
	2003	2004
	(in thousands)	
Net loss	€ (9,173)	€ (12,604)
Minority interest	(8,499)	(3,936)
Income taxes	226	(37)
Interest expense	6,887	9,554
Investment income	(1,055)	(1,679)
Derivative financial instruments	3,604	1,077
Impairment of investments	5,511	
Other	(20)	
	_____	_____
Loss from operations	(2,519)	(7,625)
Add: Depreciation and amortization	18,135	17,217
Impairment charge		6,000
	_____	_____
Operating EBITDA	€ 15,616	€ 15,592
	_____	_____

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

In the year ended December 31, 2003, total revenues decreased to €194.6 million from €239.1 million in the year ended December 31, 2002, primarily as the current period does not include

the revenues of the Landqart AG, referred to as "Landqart", specialty paper mill, which we reorganized in December 2002 and now account for under the equity method. Primarily as a result thereof, pulp and paper revenues decreased to €182.5 million in the current period from €227.9 million in 2002.

Cost of pulp and paper sales in the year ended December 31, 2003 decreased to €179.7 million from €213.5 million in the year ended December 31, 2002, primarily as a result of the deconsolidation of Landqart.

Pulp sales in the current period were €126.6 million, compared to €130.2 million in 2002. U.S. dollar denominated list pulp price increases were mostly offset by a 17% decline in the U.S. dollar against the Euro in 2003. Average list prices for NBSK pulp in Europe were approximately €420 (\$440) per ADMT at the end of 2002, approximately €441 (\$480) per ADMT in the first quarter of 2003, approximately €484 (\$550) per ADMT in the second quarter of 2003, approximately €444 (\$500) per ADMT in the third quarter of 2003 and approximately €444 (\$560) per ADMT in the fourth quarter of 2003. Our pulp sales realizations were €417 per ADMT on average in the current period, compared to €443 per ADMT in 2002. Pulp sales by volume increased to 303,655 ADMTs in the current period from 293,607 ADMTs in 2002.

Cost of sales and general and administrative expenses for the pulp operations were €136.6 million for the year ended December 31, 2003, compared to €138.9 million for the year ended December 31, 2002. On average, fiber costs for pulp production in the current period generally remained at the same level as in the year ended December 31, 2002. Depreciation within the pulp segment was €21.9 million in the current period, compared to €21.6 million in 2002.

Our pulp operations generated operating income of €0.1 million in the year ended December 31, 2003, compared to operating income of €1.8 million in 2002.

Results for our paper segment during the current period reflect the aforementioned exclusion of the results from the Landqart specialty paper mill, which were included in the results for the prior year. Paper sales in the current period decreased to €55.9 million from €97.7 million in 2002. Sales of specialty papers in the year ended December 31, 2003 decreased to €40.1 million from €79.4 million in the year ended December 31, 2002. Total paper sales volumes decreased to 62,018 ADMTs in the year ended December 31, 2003 from 84,922 ADMTs in the year ended December 31, 2002. On average, prices for specialty papers realized in the year ended December 31, 2003 decreased by approximately 23.3% as our product mix changed upon the deconsolidation of the Landqart mill, and for printing papers decreased by approximately 6.8%, compared to the year ended December 31, 2002.

Cost of sales and general and administrative expenses for the paper operations decreased to €57.9 million in the current period from €101.0 million in 2002 as a result of lower paper sales. Paper segment depreciation decreased to €2.0 million in the year ended December 31, 2003 from €4.0 million in the prior period.

Our paper operations generated operating income of €0.1 million in the year ended December 31, 2003, compared to an operating loss of €4.5 million in the year ended December 31, 2002.

Consolidated general and administrative expenses decreased to €19.3 million in the year ended December 31, 2003 from €25.0 million in the year ended December 31, 2002, primarily as a result of the exclusion of the results of the Landqart mill and a decrease in professional fees in the current period.

For the year ended December 31, 2003, we reported a loss from operations of €4.5 million, compared to €1.1 million in 2002. Interest expense (excluding capitalized interest of €17.4 million in respect of the Stendal project) in the current period decreased to €11.5 million from €13.8 million in 2002, primarily as a result of lower borrowing costs and lower indebtedness for our operating units.

During the current period, we made principal repayments of €13.2 million in respect of the indebtedness of the Rosenthal pulp mill.

Pursuant to the Stendal Loan Facility, Stendal entered into the Stendal Interest Rate Swaps for the full term of the facility to manage the risk exposure with respect to an aggregate maximum amount of approximately €612.6 million of the principal amount of the Stendal Loan Facility. Under these swaps, Stendal pays a fixed rate and receives a floating rate with respect to interest payments calculated on a notional amount. These swaps manage the exposure to variable cash flow risk from the variable interest payments under the Stendal Loan Facility. Stendal also entered into a currency forward contract in connection with the Stendal Loan Facility in the third quarter of 2003. These derivatives are marked to market at the end of each reporting period and all unrealized gains and losses are recognized in earnings for such period. In 2003, we recorded a non-cash holding loss of approximately €13.0 million when these swaps were marked to market at the end of the period, compared to a non-cash holding loss of approximately €30.1 million in 2002. A non-cash holding gain of €0.7 million before minority interests was recognized in respect of the currency forward in the year ended December 31, 2003. We determine market valuations based primarily upon values provided by our counterparties.

In addition, Rosenthal had entered into currency swaps to manage its exposure with respect to an aggregate amount of approximately €198.4 million of the principal long-term indebtedness of the Rosenthal mill under the Rosenthal Loan Facility. Rosenthal had also entered into currency forwards and forward interest rate and interest cap contracts in connection with certain indebtedness relating to the Rosenthal mill. The currency swaps and the currency forwards were settled in December 2003. These derivatives are also marked to market at the end of each reporting period, and all gains and losses are recognized in earnings for such period. Primarily as a result of the weakening of the U.S. dollar versus the Euro, in the current year we recognized a net gain of €28.5 million upon the settlement of the currency swaps and currency forwards and the marked to market valuation of the forward interest rate and interest cap contracts. In 2002, we recognized a net gain of €23.4 million from these derivative contracts.

Minority interest in the year ended December 31, 2003 amounted to €5.6 million and represented the proportion of the loss of the Stendal project allocated to the two minority shareholders of Stendal. Minority interest in the year ended December 31, 2002 amounted to €11.0 million.

Our results for the year ended December 31, 2003 include an adjustment of €5.6 million for the non-cash aggregate pre-tax earnings impact of other-than-temporary impairment losses on certain of our available-for-sale securities. This adjustment was recorded in other income (expense) in our consolidated statement of operations. This adjustment did not affect our shareholders' equity since all of our available-for-sale securities are marked to market on a quarterly basis and unrealized gains or losses are reported through the statement of comprehensive income in our financial statements and recorded in other comprehensive income (loss) within shareholders' equity on our balance sheet. Such unrealized gains or losses, the cost base and the current marked to market value of our available-for-sale securities are further described in the notes to our annual financial statements. These were legacy investments and unrelated to our pulp and paper operations and were largely sold in December 2003.

SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, EITF 03-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*, and SEC Staff Accounting Bulletin 59, *Accounting for Noncurrent Marketable Equity Securities*, provide guidance on determining when an impairment is other-than-temporary, which requires judgment. In making this judgment, we evaluate, among other factors, the duration and extent to which the fair value of an investment is less than its cost; the financial health of and business outlook for the investee, including factors such as industry and sector performance, changes in technology, operational and financing cash flow, the investee's financial position including its appraisal and net asset value, market prices, its business plan and investment strategy; and our intent and ability to hold the investment.

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During 2003, we recorded a reserve for potential tax obligations of €3.0 million and an asset write-down of €2.3 million related to the valuation of certain assets in which we have a non-controlling interest as a result of the Landqart reorganization in 2002. No similar reserves or write-downs were recorded in 2002. Our results for 2003 also include a one-time pre-tax charge of approximately €1.0 million for settlement expenses relating to a proxy solicitation and settlement agreement with respect to our 2003 annual meeting.

For the year ended December 31, 2003, we reported a net loss of €3.6 million, or €0.21 per share on a basic and diluted basis, compared to a net loss of €6.3 million, or €0.38 per share on a basic and diluted basis, in the year ended December 31, 2002.

As the Stendal project was under construction and because of its overall size relative to our other facilities, management uses consolidated operating results excluding derivative items relating to the Stendal project to measure the performance and results of our operating units. Management believes this measure provides meaningful information for it and securityholders on the performance of our operating facilities for a reporting period. Upon completion of the ramp-up phase for the Stendal mill, the Stendal project will be evaluated with our other operating units. For the year ended December 31, 2003, we reported a net loss of €3.6 million or €0.21 per share on a diluted basis. If we had excluded items relating to the Stendal project by adding the loss on derivative financial instruments of €13.0 million on the Stendal Interest Rate Swap Agreements to, and subtracting the gain on the currency forward relating to the Stendal Loan Facility of €0.7 million and minority interest of €5.6 million from, the reported net loss of €3.6 million, we would have reported net income of €3.1 million or €0.18 per share on a diluted basis. For the year ended December 31, 2002, we reported a net loss of €6.3 million or €0.38 per share on a diluted basis. If we had excluded items relating to the Stendal project by adding the loss on derivative financial instruments of €30.1 million on the Stendal Interest Rate Swap Agreements to, and subtracting minority interests of €11.0 million from, the reported net loss of €6.3 million, we would have reported net income of €12.8 million or €0.76 per share on a diluted basis. This measure 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.

We generated "Operating EBITDA" of €19.6 million in the current period, compared to Operating EBITDA of €24.5 million in 2002. Operating EBITDA is defined as income (loss) from operations plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA is calculated by adding depreciation and amortization of €24.1 million and €25.6 million to the loss from operations of €4.5 million and €1.1 million for the years ended December 31, 2003 and 2002, respectively.

Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our results for the nine months ended September 30, 2004 for additional information relating to Operating EBITDA.

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

	Year Ended December 31,	
	2002	2003
	(in thousands)	
Net loss	€ (6,322)	€ (3,593)
Minority interest	(10,965)	(5,647)
Income taxes	(264)	3,172
Interest expense	13,753	11,523
Investment income	(436)	(1,653)
Derivative financial instruments	6,679	(16,168)
Impairment of investments		7,825
Other	(3,590)	
Loss from operations	(1,145)	(4,541)
Add: Depreciation and amortization	25,614	24,105
Operating EBITDA	€ 24,469	€ 19,564

Year Ended December 31, 2002 Compared to the Year Ended December 31, 2001

In 2002, total revenues increased by approximately 10.5% to €239.1 million from €216.4 million in 2001, primarily as a result of increased sales of specialty papers resulting from the acquisition of the Landqart mill in December 2001. In 2002, pulp and paper revenues increased by approximately 11.2% to €227.9 million from €205.0 million in 2001, on a 66.3% increase in paper sales partially offset by an 11.0% decrease in pulp sales.

Costs of sales in 2002 increased to €213.5 million from €184.7 million in 2001, primarily as a result of higher revenues.

Pulp sales in 2002 decreased to €130.2 million from €146.2 million in 2001, as global economic weakness and high producer inventory levels led to lower prices. List prices for kraft pulp in Europe decreased from approximately €528 (\$470) per ADMT at the end of 2001 to approximately €420 (\$440) per ADMT at the end of the fourth quarter of 2002, before improving in early 2003 due primarily to supply disruptions. Our pulp sales realizations in 2002 decreased to €443 per ADMT from €512 per ADMT in 2001 as a result of such lower sales prices and the weaker dollar versus the Euro during 2002 compared to the prior period. Pulp sales by volume increased to 293,607 ADMTs in 2002 from 285,654 ADMTs in 2001, when we had 19 days of unscheduled technical downtime at the Rosenthal mill.

Cost of sales and general and administrative expenses for our pulp operations decreased to €138.9 million in 2002 from €140.4 million in 2001 despite higher production and sales volumes. On average, our fiber costs per ADMT for pulp production decreased by approximately 5.8% in 2002 compared to 2001 primarily because of lower fiber costs. Additionally, efficiency improvements at the Rosenthal mill also reduced energy and chemical costs relative to 2001. Depreciation was €21.6 million in 2002 compared to €21.4 million in 2001. In 2002, our average production costs per ADMT (excluding depreciation) were reduced by approximately 9% compared to 2001.

Our pulp operations generated €1.8 million of income from operations in 2002, compared to €18.6 million in 2001.

Paper sales in 2002 increased to €97.7 million from €58.8 million in 2001. Sales of specialty papers in 2002 increased to €79.4 million from €36.0 million in 2001 as a result of the inclusion of the results of the Landqart mill, which contributed sales volumes of 18,222 ADMTs in 2002. Excluding Landqart,

our sales volumes for these grades increased to 43,505 ADMTs in 2002 from 40,437 ADMTs in 2001. This increase in specialty paper sales is largely the result of our strategy to focus on niche products. In response to market conditions, we adjusted our product mix to more specialty products at our Heidenau mill where volumes of printing papers decreased to 23,195 ADMTs in 2002 from 26,815 ADMTs in the prior period. On average, prices for specialty papers realized in 2002 increased by approximately 44.6% and for printing papers decreased by approximately 6.9%, compared to 2001.

Cost of sales and general and administrative expenses for our paper operations increased to €101.0 million in 2002 from €61.7 million in 2001 as a result of the inclusion of Landqart. This increase was partially offset by lower raw material prices, particularly for virgin pulp and waste paper as compared to 2001. Furthermore, the flooding experienced at our Heidenau and Fährbrücke paper mills in August 2002 resulted in a period of reduced production and increased costs. Depreciation increased to €4.0 million in 2002 from €1.5 million in the prior year, as a result of the inclusion of Landqart.

A loss from operations of €4.5 million was recorded by our paper operations in 2002 relative to a €2.5 million loss from operations in 2001.

General and administrative expenses increased to €25.0 million in 2002 from €18.4 million in 2001, primarily as a result of the inclusion of the results of the Landqart mill and a foreign exchange transaction loss of €3.0 million in 2002. In 2001, we recorded a foreign exchange transaction gain of €3.4 million.

We had a loss from operations of €1.1 million in 2002, compared to income from operations of €13.3 million in 2001. Interest expense (excluding capitalized interest of €3.1 million in respect of the Stendal project) in 2002 decreased to €13.8 million from €16.2 million in 2001, primarily as a result of repayments made on outstanding indebtedness.

We recognized a holding loss of €30.1 million before minority interests in respect of the Stendal Interest Rate Swaps for the year ended December 31, 2002.

During 2002, we settled two currency swaps which were entered into earlier in the year to realize gains. We then subsequently re-entered into two currency swaps and one of them was settled and a gain was realized in December 2002. In addition, we have entered into currency forwards and forward interest rate and interest cap contracts in connection with certain indebtedness relating to the Rosenthal mill. These derivatives are also marked to market at the end of each reporting period and all gains and losses are recognized in earnings for a reporting period. In 2002, we realized a total gain of €23.4 million from these derivative contracts.

Income tax impacts were negligible in both 2002 and 2001 given the pre-tax losses sustained in both years. Minority interest in 2002 amounted to €11.0 million and represented the minority shareholders' interest in the losses of Stendal. There was no minority interest in 2001.

For 2002, we reported a net loss of €6.3 million, or €0.38 per share on a basic and diluted basis, compared to a net loss of €2.8 million, or €0.17 per share on a basic and diluted basis, in 2001.

For 2002, excluding items related to the Stendal project, net income would have been €12.8 million, or €0.76 per share on a diluted basis, which was determined by adding the loss on derivative financial instruments of €30.1 million to, and subtracting minority interests of €11.0 million from, the reported net loss of €6.3 million. As the Stendal project is currently under construction and because of its overall size relative to our other facilities, management uses our consolidated operating results excluding items relating to the Stendal project to measure the performance and results of our operating units. Management believes this measure provides meaningful information on the performance of our operating facilities for a reporting period.

We generated "Operating EBITDA" of €24.5 million in the current period, compared to Operating EBITDA of €36.3 million in 2001. Operating EBITDA is defined as income (loss) from operations plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA

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is calculated by adding depreciation and amortization of €25.6 million and €23.0 million to the income (loss) from operations of €(1.1) million and €13.3 million for the years ended December 31, 2002 and 2001, respectively.

Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our results for the nine months ended September 30, 2004 for additional information relating to Operating EBITDA.

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

	Year Ended December 31,	
	2001	2002
	(in thousands)	
Net loss	€ (2,823)	€ (6,322)
Minority interest		(10,965)
Income taxes	83	(264)
Interest expense	16,170	13,753
Investment income	(2,872)	(436)
Derivative financial instruments	2,504	6,679
Impairment of investments		
Other	270	(3,590)
	13,332	(1,145)
Income (loss) from operations	13,332	(1,145)
Add: Depreciation and amortization	22,966	25,614
	36,298	24,469
Operating EBITDA	€ 36,298	€ 24,469

Liquidity and Capital Resources

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

	As at December 31,		As at September 30,
	2002	2003	2004
	(in thousands)		
Financial Position			
Cash and cash equivalents	€ 30,261	€ 51,993	€ 42,643
Working capital (deficit)	6,328	(48,947) ⁽¹⁾	(122,474) ⁽¹⁾
Properties, net	441,990	745,178	942,249
Total assets	599,750	935,905	1,192,727
Long-term liabilities	384,892	625,702	778,939
Shareholders' equity	124,969	132,855	121,595

(1) As at December 31, 2003 and September 30, 2004, we had a working capital deficit of €48.9 million and €122.5 million, respectively, primarily as a result of Stendal construction costs payable of €42.8 million and €161.0 million during the respective periods for which we had not drawn down under the Stendal Loan Facility. We qualify for investment grants from the federal and state governments of Germany and had claim expenditures of €82.1 million and €65.2 million outstanding at December 31, 2003 and September 30, 2004, respectively. We expect to receive our currently outstanding claim expenditures in 2005. However, in accordance with our accounting policies, we do not record these grants until they are received.

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At September 30, 2004, our cash and cash equivalents were €42.6 million, compared to €52.0 million at December 31, 2003. We also had €29.3 million of cash restricted to pay construction costs payable and €19.1 million of cash restricted in a debt service account, both related to the Stendal

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project. In addition, we had €28.5 million of cash restricted in a debt service account relating to the Rosenthal Loan Facility. At September 30, 2004, we had a working capital deficit of €122.5 million, primarily because we had Stendal construction costs payable of €161.0 million for which we had not yet drawn down under the Stendal Loan Facility and, under our accounting policies, we do not record certain government grants until they are received. The Stendal construction costs will be paid pursuant to the Stendal Loan Facility in the ordinary course. At September 30, 2004, we qualified for investment grants related to the Stendal mill totaling approximately €65.2 million from the federal and state governments of Germany, which we expect to receive in 2005. Approximately €61.2 million of these grants, when received, will be applied to repay the amounts drawn under the dedicated tranche of the Stendal Loan Facility. The grants are not reported in our income and reduce the cost basis of the assets purchased when they are received. We expect to qualify for additional investment grants totaling €23.3 million when such Stendal construction costs have been substantially paid.

In October 2003, we completed the sale of \$82.5 million in aggregate principal amount of convertible senior subordinated notes due October 2010. The notes bear interest at a rate of 8.5% per annum and are convertible into our shares of beneficial interest at a conversion price of \$7.75 per share. The net proceeds from the offering of approximately \$78.4 million were used to repay in full our indebtedness, including fees and accrued interest, under two bridge loan facilities aggregating approximately \$66.9 million and the balance was used for general corporate purposes, including working capital.

We expect to continue to generate sufficient cash flow from operations to pay our interest and debt service expenses and meet the working and maintenance capital requirements for our current operations. Our only revolving credit facility is at our Stendal mill. We intend to enter into two new working capital facilities for the Rosenthal and Celgar mills. See "Use of Proceeds", "The Financings" and "Description of Certain Indebtedness - New Working Capital Facilities".

From time to time, we have entered into project specific credit facilities to finance capital projects and expect to continue to do so, subject to availability. We expect to meet the capital requirements for the Stendal mill, including working capital and potential losses during start-up, through shareholder advances already made to Stendal, the Stendal Loan Facility, the receipt of government grants and cash flow from operations. See "Business - Stendal Pulp Mill Project and Financing" and "Description of Certain Indebtedness - Stendal Pulp Mill Project Financing".

Operating Activities

Operating activities in 2003 provided cash of €31.4 million, compared to €40.4 million in 2002. Net changes in trading securities provided cash of €0.3 million in 2003, compared to €4.4 million in 2002. An increase in receivables due primarily to higher sales in December 2003 used cash of €4.7 million in 2003, compared to a decrease in receivables providing cash of €18.2 million in 2002. An increase in inventories due primarily to the build up of fiber in connection with the start-up of the Stendal mill used cash of €7.5 million in 2003, compared to a decrease in inventories providing cash of €1.7 million in 2002. A decrease in cumulative unrealized gains on derivatives provided cash of €3.8 million in 2003, compared to an increase in the same using cash of €3.3 million in 2002. An increase in accounts payable and accrued expenses provided cash of €1.1 million in 2003, compared to a decrease in the same using cash of €12.7 million in 2002.

Operating activities in the nine months ended September 30, 2004 used cash of €1.2 million, compared to providing cash of €7.0 million in the comparative period of 2003. An increase in receivables related primarily to the start-up of the Stendal mill used cash of €2.1 million in the nine months ended September 30, 2004, compared to using cash of €8.1 million in the comparative period of 2003. Higher inventories due primarily to the build up of fiber and finished goods in connection with the start-up of the Stendal mill used cash of €35.8 million in the first nine months of 2004, compared to higher inventories using cash of €6.6 million in the first nine months of 2003. We expect that as the

Stendal mill ramps up operations, inventory levels at the mill will decrease to more normalized levels. An increase in accounts payable and accrued expenses related primarily to the start-up of the Stendal mill provided cash of €26.3 million in the nine months ended September 30, 2004, compared to providing cash of €11.6 million in the comparative period of 2003.

Investing Activities

Investing activities in 2003 used cash of €318.5 million, primarily as a result of the acquisition of properties, net of investment grants, of which €316.7 million was attributable to the Stendal project, compared to €195.7 million in 2002, of which €186.6 million was attributable to the Stendal project. Sales of available-for-sale securities provided cash of €6.4 million in 2003.

Investing activities in the nine months ended September 30, 2004 used cash of €211.8 million, primarily as a result of the acquisition of properties, net of investment grants, of which €206.9 million was attributable to the Stendal project, compared to using cash of €225.9 million in the nine months ended September 30, 2003, of which €145.9 million was attributable to the Stendal project. Sales of certain legacy available-for-sale securities provided cash of €1.2 million in the nine months ended September 30, 2004.

We qualify for investment grants from the federal and state governments of Germany and had claim expenditures of €65.2 million outstanding as of September 30, 2004. We expect to receive our currently outstanding claim expenditures in 2005. We received investment grants totaling €82.7 million and €103.0 million with respect to the Stendal project during 2003 and the first nine months of 2004, respectively. In accordance with our accounting policies, we do not record these grants until they are received. These grants reduce the cost basis of the assets purchased with them. See "Business Government Financing".

We are in the process of constructing a wastewater treatment plant at the Fährbrücke mill and have completed reconstructing the landfill at the Rosenthal mill. See "Business Environmental" and "Business Capital Expenditures".

In August 2002, we completed financing arrangements for the Stendal project. Total investment costs in connection with the project are approximately €1.0 billion, the majority of which was provided under the Stendal Loan Facility. We also contributed approximately €63.5 million to Stendal. For more information about the Stendal project, see "Business Stendal Pulp Mill Project and Financing" and "Business Capital Expenditures".

Financing Activities

Financing activities provided cash of €307.1 million in the year ended December 31, 2003. A net increase in indebtedness, primarily related to the Stendal project, provided cash of €299.0 million. An increase in restricted cash used cash of €11.1 million in 2003. We made principal repayments of €13.2 million in connection with the Rosenthal Loan Facility in the year ended December 31, 2003. The issuance of shares in connection with the exercise of options provided cash of €0.9 million in 2003. Financing activities provided cash of €174.7 million in 2002, primarily as a result of a net increase in indebtedness relating to the Stendal project.

Financing activities provided cash of €203.6 million in the nine months ended September 30, 2004. A net increase in indebtedness, primarily related to the Stendal project, provided cash of €104.1 million. An increase in construction costs payable provided cash of €118.2 million. An increase in restricted cash used cash of €17.5 million. We made principal repayments of €20.1 million in connection with the Rosenthal Loan Facility in the nine months ended September 30, 2004. The balance outstanding under such facility at September 30, 2004, net of cash in a restricted debt service account, was €143.1 million. The issuance of shares in connection with the exercise of options provided cash of €0.6 million in the nine months ended September 30, 2004. Financing activities provided cash of €206.2 million in the first nine months of 2003, primarily as a result of an increase in construction costs payable relating to the Stendal project and an increase in indebtedness primarily in connection with the Stendal project.

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In 2003, our paper operations secured two term credit facilities aggregating approximately €2.5 million, which facilities along with certain government grants were utilized to repair flooding damage suffered by the mills in 2002. For information about these credit facilities, see "Description of Certain Indebtedness - Paper Mill Project Facilities".

In addition, in 2003, our Fährbrücke paper mill secured three credit facilities aggregating €5.5 million, which facilities along with certain government grants are utilized to finance equipment and construction costs associated with expanding, adapting and improving the efficiency of the paper machine at the mill. In September 2004, we repaid the majority of the outstanding amounts under these credit facilities and permanently reduced the aggregate amount available thereunder to €2.2 million. For information about these credit facilities, see "Description of Certain Indebtedness - Paper Mill Project Facilities". As at September 30, 2004, we had utilized the entire €4.7 million available under the five credit facilities relating to the paper operations.

Other than the Acquisition Agreement, we have no material commitments to acquire assets or operating businesses. The Acquisition is being financed through the offering of notes hereunder and the Share Offering. We anticipate that there will be acquisitions of businesses or commitments to projects in the future. To achieve our long-term goals of expanding our asset and earnings base through the acquisition of interests in companies and assets in the pulp and paper and related businesses, and organically through high return capital expenditures at our operating facilities, we will require substantial capital resources. The required necessary resources for such long-term goals will be generated from cash flow from operations, cash on hand, the sale of securities and/or assets, and borrowing against our assets, subject to the restrictions in the indenture governing the notes issued hereunder.

In addition, we have amounts available under the revolving portion of the Stendal Loan Facility, and the two new revolving working capital facilities to be established for the Rosenthal and Celgar mills. See "The Financings" and "Description of Certain Indebtedness - New Working Capital Facilities".

Contractual Obligations and Commitments

The following table sets out our contractual obligations and commitments as at December 31, 2003 in connection with our long-term liabilities. These obligations and commitments are expected to increase in the future to reflect the start-up of the Stendal mill and the Acquisition.

Contractual Obligations	Payments Due By Period				
	2004	2005-2006	2007-2008	Beyond 2008	Total
	(in thousands)				
Long-term debt ⁽¹⁾	€ 15,801	€ 34,116	€ 38,836	€ 182,949	€ 271,702
Construction in progress, Stendal ⁽²⁾		18,248	48,877	267,467	334,592
Capital lease obligations ⁽³⁾	1,932	1,854	453		4,239
Operating lease obligations ⁽⁴⁾	2,097	3,149	3,280	80	8,606
Purchase obligations ⁽⁵⁾	37,764	44,382	4,117		86,263
Other long-term liabilities ⁽⁶⁾	27		125	57	209
Total	€ 57,621	€ 101,749	€ 95,688	€ 450,553	€ 705,611

(1) This reflects principal only relating primarily to indebtedness under the Rosenthal Loan Facility, which will be repaid from the proceeds of the Financings, and credit facilities relating to the paper mills, but does not reflect indebtedness relating to the Stendal project. See "Description of Certain Indebtedness", footnote 2 below and Note 9 to our annual financial statements included herein for a description of such indebtedness. Does not include amounts associated with derivatives entered into in connection with indebtedness relating to the Rosenthal mill, which we intend to settle as part of the Rosenthal refinancing. See "Quantitative and Qualitative Disclosure about Market Risk" for information about our derivatives.

- (2) This reflects principal only in connection with indebtedness relating to the Stendal project, including under the Stendal Loan Facility and convertible notes. See "Description of Certain Indebtedness" and Note 9 to our annual financial statements included herein for a description of such indebtedness. Does not include amounts associated with derivatives entered into in connection with the Stendal Loan Facility. See " Quantitative and Qualitative Disclosure about Market Risk" for information about our derivatives.
- (3) Capital lease obligations relate to transportation vehicles and production equipment. These amounts reflect principal and interest.
- (4) Operating lease obligations relate to transportation vehicles and other production and office equipment.
- (5) Purchase obligations relate primarily to take-or-pay contracts made in the ordinary course of business, of which purchases of raw materials and supplies totaled approximately €85.0 million.
- (6) Other long-term liabilities relate primarily to pension liability. Does not include obligations under employment agreements.

Capital Resources

In addition to our new €40 million and \$30 million revolving credit facilities for the Rosenthal and Celgar mills, respectively, we may seek to raise future funding in the debt markets if our indenture permits, subject to compliance with the indenture. The indenture governing the notes will contain various restrictive covenants, including several that are based on a formulation of the financial measure EBITDA, which is net income (loss) adjusted to exclude interest, taxes, depreciation and amortization, certain non-cash charges and extraordinary or otherwise unusual gains or losses, and certain other items. We refer to this formulation of EBITDA as "Indenture EBITDA" which is defined in the note indenture as Consolidated EBITDA.

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The following table sets forth the applicable components of Indenture EBITDA for the pro forma restricted group and also serves as a reconciliation to net income (loss) on a GAAP basis for the periods indicated:

	Pro Forma Restricted Group		
	Year Ended Dec. 31, 2003	Nine Months Ended September 30,	
		2003	2004
		(unaudited) (in thousands)	
Net loss, GAAP	€ (3,447)	€ (23,965)	€ (435)
Foreign exchange gain on indebtedness	(14,571)	(11,654)	(1,791)
Marked to market gain (loss) on hedging obligations	(27,347)	367	(1,293)
Indenture net income	(45,365)	(35,252)	(3,519)
Equity losses	1,676	912	554
Indenture consolidated net income	(43,689)	(34,340)	(2,965)
Income taxes	3,172	226	(37)
Interest expense	29,297	21,781	22,521
Depreciation and amortization	33,985	25,269	23,587
Impairment of investments	6,735	4,441	
Mercer stock compensation expense ⁽¹⁾	454	432	690
Mercer special shareholder costs ⁽²⁾	601	212	
Acquisition expenses			58
Mercer corporate reorganization costs ⁽³⁾	251		567
Celgar foreign exchange losses ⁽⁴⁾	3,769	3,119	566
Celgar lime kiln costs ⁽⁵⁾	1,982	1,283	59
Accrued interest income	(3,582)	(2,966)	(1,104)
Indenture EBITDA	€ 32,975	€ 19,457	€ 43,942

- (1) Mercer stock compensation expense is a non-cash expense related to stock options issued to trustees and officers.
- (2) Mercer special shareholder costs are related to a proxy contest which occurred in connection with our annual meeting of shareholders held on August 22, 2003 resulting in additional proxy solicitation, settlement and related costs.
- (3) Mercer corporate reorganization costs are related to an internal corporate reorganization effected by Mercer within its German subsidiaries.
- (4) Celgar foreign exchange losses are related to foreign exchange losses on current receivables and payables resulting from currency fluctuations.
- (5) Celgar lime kiln costs are additional incremental costs related to a burner misalignment at the Celgar lime kiln.

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The indenture governing the notes will provide that, in order to enter into certain types of transactions, including the incurrence of additional indebtedness, the making of restricted payments and the completion of mergers and consolidations, we must meet a minimum ratio of Indenture EBITDA to Fixed Charges as defined in the note indenture of 2.0 to 1.0 on a pro forma basis for the most recently ended four full fiscal quarters. This ratio is referred to and defined as the Fixed Charge Coverage Ratio in the note indenture. See "Description of the Notes". Indenture EBITDA provides additional information with respect to our ability to incur debt and make distributions and should be used primarily for the purposes of determining our ability to incur additional debt beyond our revolving credit facilities and certain other permitted borrowings that are independent of this ratio.

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Fixed charges, as defined in the note indenture, for the pro forma restricted group were comprised only of interest expense for the year ended December 31, 2003 and for the nine months ended September 30, 2003 and 2004. For the four quarters ending September 30, 2004, we calculate the Fixed Charge Coverage Ratio for the pro forma restricted group to be 1.9.

For a description of our credit facilities, see "Description of Certain Indebtedness".

Sensitivity Analysis

The pulp and paper business is cyclical in nature and markets for our principal products are characterized by periods of supply and demand imbalance, which in turn affects product prices. The markets for pulp and paper are highly competitive and sensitive to changes in industry capacity and in the economy, both of which can have a significant influence on our selling prices and earnings. Approximately €126.6 million, or approximately 69.4%, of our revenues in 2003 were from pulp sales and approximately €103.7 million, or approximately 71.5%, of our revenues in the nine months ended September 30, 2004 were from pulp sales. The following table illustrates the effect on our net operating results in 2003 and the first nine months of 2004 of a \$20 change in our average selling price per ADMT for NBSK pulp in 2003 and the first nine months of 2004, based upon our pulp sales during each period and translated into Euros at the average exchange rate for the U.S. dollar to the Euro for the period:

	Year Ended December 31, 2003	Nine Months Ended September 30, 2004
	(in thousands, except per share amounts)	
NBSK Pulp \$20 per ADMT change		
Change in net loss	€ 5,367	€ 3,744
Change in net loss per share	0.32	0.22

As our Stendal mill only started production in the third quarter of 2004, we expect our sensitivity to pulp prices to increase significantly both on an absolute and per share basis in the future.

Foreign Currency

Effective January 1, 2002, we changed our reporting currency from the U.S. dollar to the Euro as a significant majority of our business transactions are originally denominated in Euros. By adopting the Euro, most cumulative foreign currency translation losses were eliminated. However, we hold certain assets and liabilities in U.S. dollars, Swiss francs and, to a lesser extent, in Canadian dollars. Accordingly, our consolidated financial results are subject to foreign currency exchange rate fluctuations.

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

In the year ended December 31, 2003, we reported a net €2.5 million foreign exchange translation gain and in the nine months ended September 30, 2004, we reported a net €0.3 million foreign exchange translation loss, and, as a result, the cumulative foreign exchange translation gain increased to €6.0 million at December 31, 2003 from €3.5 million at December 31, 2002 and decreased to €5.7 million at September 30, 2004 from €6.0 million from December 31, 2003.

Based upon the exchange rate at December 31, 2003, the U.S. dollar decreased by approximately 17% in value against the Euro since December 31, 2002 and, based on the average exchange rate for the nine months ended September 30, 2004, the U.S. dollar decreased by approximately 6.2% in value

against the Euro since September 30, 2003. 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 the amounts reported in the financial statements and accompanying notes. Estimates are used for, but not limited to, the accounting for doubtful accounts, depreciation and amortization, asset impairments, income taxes, and contingencies. Actual results could differ from these estimates.

Our management routinely makes judgments and estimates about the effects of matters that are inherently uncertain. As the number of variables and assumptions affecting the probable future resolution of the uncertainties increase, these judgments become even more subjective and complex. We have identified certain accounting policies, described below, that are the most important to the portrayal of our current financial condition and results of operations. Our significant accounting policies are disclosed in Note 1 to our annual audited consolidated financial statements included elsewhere in this prospectus supplement. In addition, we had a change in our depreciation estimate relating to the Rosenthal mill in the nine months ended September 30, 2004. See Note 8 to our interim consolidated financial statement included elsewhere in this prospectus supplement.

Derivative Instruments. We adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" effective January 1, 2001. Derivative instruments are measured at fair value and reported in the balance sheet as assets or liabilities. Accounting for gains or losses depends on the intended use of the derivative instruments. Gains or losses on derivative instruments which are not designated hedges are recognized in earnings in the period of the change in fair value. Accounting for gains or losses on derivative instruments designated as hedges depends on the type of hedge and these gains or losses are recognized in either earnings or other comprehensive income.

We reported a non-cash holding loss of €13.0 million before minority interests in respect of the Stendal Interest Rate Swaps, a non-cash holding gain of €0.7 million before minority interests in respect of the Stendal currency forward contract and a gain of €28.5 million in respect of the Rosenthal Interest Rate Contracts and settlement of the Rosenthal currency swaps and currency forwards in our loss for the year ended December 31, 2003.

Impairment of Long-Lived Assets. We periodically evaluate long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In performing the review of recoverability, we estimate future cash flows expected to result from the use of the asset and its eventual disposition. The estimates of future cash flows, based on reasonable and supportable assumptions and projections, require our management to make subjective judgments. In addition, the time periods for estimating future cash flows is often lengthy, which increases the sensitivity of the assumptions made. Depending on the assumptions and estimates used, the estimated future cash flows projected in the evaluation of long-lived assets can vary within a wide range of outcomes. Our management considers the likelihood of possible outcomes in determining the best estimate of future cash flows.

Deferred Taxes. We currently have deferred tax assets which are comprised primarily of tax loss carryforwards and deductible temporary differences, both of which will reduce taxable income in the future. We assess the realization of these deferred tax assets on a periodic basis to determine whether a valuation allowance is required. We determine whether it is more likely than not that all or a portion

of the deferred tax assets will be realized, based on currently available information, including, but not limited to, the following:

the history of the tax loss carryforwards and their expiry dates;

our projected earnings; and

tax planning opportunities.

If we believe that it is more likely than not that some of these deferred tax assets will not be realized, based on currently available information, an income tax valuation allowance is recorded against these deferred tax assets. As at December 31, 2003, we had €84.5 million in deferred tax assets and €74.5 million in valuation allowances, resulting in a net deferred tax asset of €10.0 million.

If market conditions improve or tax planning opportunities arise in the future, we will reduce our valuation allowances, resulting in future tax benefits. If market conditions deteriorate in the future, we will increase our valuation allowances, resulting in future tax expenses. Any change in tax laws, particularly in Germany, will change the valuation allowances in future periods.

Environmental. Our operations are subject to a wide range of German federal, state and local environmental laws and regulations, dealing primarily with water, air and land pollution control. In recent years, we have devoted significant financial and management resources to comply with all applicable environmental laws and regulations. We believe our operations are currently in substantial compliance with the requirements of all applicable environmental laws and regulations and our respective operating permits.

Under German state environmental rules relating to effluent discharges, industrial users are required to pay wastewater fees based upon the amount of their effluent discharge. These rules also provide that an industrial user which undertakes environmental capital expenditures and lowers certain effluent discharges to prescribed levels may offset the amount of these expenditures against the wastewater fees that they would otherwise be required to pay in a three-year period. The requirement and timing of capital expenditures and the amount of wastewater fee charges are subject to negotiation with government agencies. As a result, we believe that our capital investment programs for our manufacturing plants will fully offset the wastewater fees that would have been payable for the past three years, subject to environmental audits. We estimate the aggregate wastewater fees offset by capital expenditures for the past three years to be approximately €9.6 million.

Other than wastewater fees, we accrue for environmental remediation liabilities on a site-by-site basis when it is probable that a loss can be reasonably estimated, or as a result of an environmental action or claim, environmental studies that we conduct or regulatory assessment. As at December 31, 2003, we recorded a liability for environmental conservation expenditures of €1.8 million, based on environmental studies that we conducted. We believe that the liability amount recorded is sufficient, subject to future changes in German environmental regulations.

Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risks from changes in interest rates, foreign currency exchange rates, particularly the exchange rate between the U.S. dollar and the Euro, and equity prices which may affect our results of operations and financial condition and, consequently, our fair value. We manage these risks through internal risk management policies as well as the use of derivatives. We use derivatives to reduce or limit our exposure to interest rate and currency risks. We may in the future use derivatives to reduce or limit our exposure to fluctuations in pulp prices. We also use derivatives to reduce our potential losses or to augment our potential gains, depending on our management's perception of future economic events and developments. These types of derivatives are generally highly speculative in

nature. They are also very volatile as they are highly leveraged given that margin requirements are relatively low in proportion to notional amounts.

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

Derivatives

Derivatives are contracts between two parties where payments between the parties are dependent upon movements in the price of an underlying asset, index or financial rate. Examples of derivatives include swaps, options and forward rate agreements. The notional amount of the derivatives is the contract amount used as a reference point to calculate the payments to be exchanged between the two parties and the notional amount itself is not generally exchanged by the parties.

The principal derivatives we use are foreign exchange derivatives and interest rate derivatives.

Foreign exchange derivatives include currency swaps which involve the exchange of fixed payments in one currency for the receipt of fixed payments in another currency. Such cross currency swaps involve the exchange of both interest and principal amounts in two different currencies. They also include foreign exchange forwards which are contractual obligations in which two counterparties agree to exchange one currency for another at a specified price for settlement at a pre-determined future date. Forward contracts are effectively tailor-made agreements that are transacted between counterparties in the over-the-counter market.

Interest rate derivatives include interest rate forwards (forward rate agreements) which are contractual obligations to buy or sell an interest-rate-sensitive financial instrument on a future date at a specified price. Forward contracts are effectively tailor-made agreements that are transacted between different counterparties in the over-the-counter market. They also include interest rate swaps which are over-the-counter contracts in which two counterparties exchange interest payments based upon rates applied to a notional amount.

We use foreign exchange derivatives to convert some of our costs (including currency swaps relating to our long-term indebtedness) from Euros to U.S. dollars. We use interest rate derivatives to fix the rate of interest on indebtedness under the Rosenthal Loan Facility and the Stendal Loan Facility.

All of the derivatives we entered into were pursuant to the Rosenthal Loan Facility and the Stendal Loan Facility, each of which provide facilities for foreign exchange derivatives, interest rate derivatives and commodities derivatives, subject to prescribed controls, including maximum notional and at-risk amounts. These credit facilities are secured by substantially all of the assets of the Rosenthal and Stendal pulp mills, respectively, and have the benefit of certain German governmental guarantees. These credit facilities do not have any separate margin requirements when derivatives are entered into pursuant to the terms and conditions thereof and are subsequently marked to market.

All of the derivatives of Rosenthal and Stendal are marked to market at the end of each reporting period, and all unrealized gains and losses are recognized in earnings for a reporting period. We determine market valuations based primarily upon valuations provided by our counterparties.

In March 2004, Rosenthal entered into the Rosenthal Currency Derivatives which include two currency swaps in the aggregate principal amount of €184.5 million that mature in September 2008 and September 2013, respectively. As NBSK pulp prices are quoted in U.S. dollars and the majority of our

business transactions are denominated in Euros, Rosenthal had entered into the currency swaps to reduce the effects of exchange rate fluctuations between the U.S. dollar and the Euro on notional amounts under the Rosenthal Loan Facility. Under these currency swaps, Rosenthal effectively pays the principal and interest in U.S. dollars and at U.S. dollar borrowing rates.

The Rosenthal Currency Derivatives also include a currency forward in the notional amount of €40.7 million which matures in March 2005 that was entered into by Rosenthal to reduce or limit its exposure to currency risks and to augment its potential gains or to reduce its potential losses. In addition, Rosenthal entered into the Rosenthal Interest Rate Contracts in 2002 to either fix or limit the interest rates in connection with certain of its indebtedness.

In August 2002, Stendal entered into the Stendal Interest Rate Swaps in connection with its long-term indebtedness relating to the Stendal project to fix the interest rate under the Stendal Loan Facility at the then low level, relative to its historical trend and projected variable interest rate. These contracts were entered into under a specific credit line under the Stendal Loan Facility and are subject to prescribed controls, including certain maximum amounts for notional and at-risk amounts. Under the Stendal Interest Rate Swaps, Stendal pays a fixed rate and receives a floating rate with the interest payments being calculated on a notional amount. The interest rates payable under the Stendal Loan Facility were swapped into fixed rates based on the Eur-Euribor rate for the repayment periods of the tranches under the Stendal Loan Facility. Stendal effectively converted the Stendal Loan Facility from a variable interest rate loan into a fixed interest rate loan, thereby reducing interest rate uncertainty.

In March 2004, Stendal also entered into the Stendal Currency Derivatives which are comprised of a currency swap in the principal amount of €306.3 million which matures in April 2011 and a currency forward contract for the notional amount of €20.6 million maturing in March 2005 to reduce or limit its exposure to currency risks and to augment its potential gains or reduce its potential losses.

In December 2004, we settled the Currency Derivatives due to the substantial weakening of the U.S. dollar versus the Euro in 2004.

We are exposed to very modest credit related risks in the event of non-performance by counterparties to derivative contracts. However, we do not expect that the counterparties, which are major financial institutions, will fail to meet their obligations.

As of September 30, 2004, we have not entered into any material financial derivatives outside of our project companies, Rosenthal and Stendal, under their existing lines of credit. As at September 30, 2004, no derivative contract had been executed with respect to pulp prices.

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The following table sets forth the maturity date, the notional amount and the recognized gain or loss, for derivatives that were in effect during 2003 and the first nine months of 2004:

Derivative Instrument	Maturity Date	Notional Amount	Recognized Gain (Loss) Year Ended December 31, 2003	Notional Amount	Recognized Gain (Loss) Nine Months Ended September 30, 2004
		(in millions)	(in thousands)	(in millions)	(in millions)
				(unaudited)	(unaudited)
ROSENTHAL					
Forward Rate Agreements ⁽¹⁾	Settled	\$ 149.0	€ (89)		
Forward Rate Agreements ⁽²⁾	Settled	\$ 124.8	(7)		
Currency Swap ⁽³⁾	Settled	€ 74.5	10,002		
Currency Swap ⁽⁴⁾	Settled	€ 124.2	14,057		
Currency Forward	Settled	\$ 20.0	768		
Currency Forward	Settled	\$ 30.0	3,751		
Forward Rate Agreement	Settled	\$ 126.9	(127)		
Forward Rate Agreement ⁽⁵⁾	Settled	\$ 200.9	(343)		
			28,012		
		As at December 31, 2003		As at September 30, 2004	
				(unaudited)	
Interest Rate Cap Agreements ⁽⁶⁾	September 2007	\$ 192.6	455	\$ 178.3	€ (0.1)
Currency Swap ⁽⁷⁾	September 2008			€ 111.8	(0.4)
Currency Swap ⁽⁸⁾	April 2011			€ 72.7	(0.2)
Currency Forward	March 2005			€ 40.7	0.4
			455		(0.3)
			€ 28,467		€ (0.3)
STENDAL					
Stendal Interest Rate Swaps ⁽⁹⁾	October 2017	€ 1,419.3	€ (13,042)	€ 1,147.5	€ (15.7)
Currency Swap ⁽¹⁰⁾	April 2011			€ 306.3	14.4
Currency Forward	March 2005			€ 20.6	0.5
Currency Forward	Settled	\$ 10.0	743		
			€(12,299)		€ (0.8)

(1) Rosenthal entered into two forward interest rate contracts with notional amounts of \$74.5 million and \$74.5 million both maturing on September 30, 2003. These derivatives were settled in 2003.

(2)

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The forward rate agreement was settled in 2003.

- (3) The interest component of the swaps was required under the terms of the Rosenthal Loan Facility, and became effective for the period starting September 30, 2002. For the outstanding principal amounts of €74.5 million under the Rosenthal Loan Facility, all repayment installments from September 30, 2002 until September 30, 2013, were swapped into U.S. dollar amounts at a rate of Euro 1.0050. The interest rate was swapped into the six-month U.S. dollar/Libor plus bank margin rate with a cap of 6.8% until September 28, 2007.
- (4) The interest component of the swaps was required under the terms of the Rosenthal Loan Facility, and became effective for the period starting January 23, 2003. For the outstanding principal amounts of €124.2 million under the Rosenthal Loan Facility, all repayment installments from January 23, 2003 until September 30, 2008, were swapped into U.S. dollar amounts at a rate of Euro 1.075. The interest rate was swapped into the three month U.S. dollar/Libor plus bank margin rate with a cap of 6.8% until September 28, 2007.

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- (5) Rosenthal entered into two forward interest rate contracts with notional amounts of \$74.0 million and \$126.9 million both maturing on March 30, 2004.
- (6) Rosenthal entered into two interest rate cap contracts with notional amounts of \$106.2 million (2003: \$118.6 million) and \$72.1 million (2002: \$74.0 million), both maturing on September 28, 2007 with a strike rate of 6.8%.
- (7) For €111.8 million of the outstanding principal amount under the Rosenthal Loan Facility, all repayment installments from March 30, 2004 until September 30, 2008 were swapped into U.S. dollar amounts at a rate of U.S. 1.2398. The interest rate was swapped into the following payments: pay a fixed rate of 4.5%, pay the three-month Libor plus a spread of 0.12% and receive the three-month Euribor until September 30, 2008. These derivatives were settled in December 2004.
- (8) For €72.7 million of the outstanding principal amount under the Rosenthal Loan Facility, all repayment installments from March 30, 2004 until September 30, 2013 were swapped into U.S. dollar amounts at a rate of U.S. 1.2398. The interest rate was swapped into the six-month Libor plus a spread of 0.12% plus a bank margin of 0.7% until September 30, 2013. These derivatives were settled in December 2004.
- (9) In connection with the Stendal Loan Facility, in the third quarter of 2002 Stendal entered into the Stendal Interest Rate Swap Agreements, which are variable-to-fixed interest rate swaps, for the term of the Stendal Loan Facility, with respect to an aggregate maximum amount of approximately € 612.6 million of the principal amount of the long-term indebtedness under the Stendal Loan Facility. The swaps took effect on October 1, 2002 and are comprised of three contracts. The first contract commenced in October 2002 for a notional amount of €4.1 million, gradually increasing to €464.9 million, with an interest rate of 3.795%, and matured in May 2004. The second contract commenced in May 2004 for a notional amount of €464.9 million, gradually increasing to €612.6 million, with an interest rate of 5.28%, and matures in April 2005. The third contract is to commence in April 2005 for a notional amount of €612.6 million, with an interest rate of 5.28%, and the notional amount gradually decreases and the contract terminates upon the maturity of the Stendal Loan Facility in October 2017. As at December 31, 2003 and September 30, 2004, the notional amounts of the two outstanding contracts was (i) €464.9 million and €534.9 million and (ii) €612.6 million and €612.6 million, respectively.
- (10) For €306.3 million of the outstanding principal amount under the Stendal Loan Facility, all repayment installments from April 1, 2004 until April 1, 2011 were swapped into U.S. dollar amounts at a rate of U.S. 1.2218. The interest rate was swapped into the following payments: pay a fixed rate of 3.5% and receive the six-month Euribor. These derivatives were settled in December 2004.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS OF CELGAR**

The following discussion and analysis of the financial condition and results of operations of Celgar as at and for the nine months ended September 30, 2003 and 2004 and the three years ended December 31, 2003 should be read in conjunction with the consolidated financial statements and related notes of Celgar included elsewhere in this prospectus supplement. Celgar prepares its financial statements in accordance with Canadian GAAP, which differs in certain respects from GAAP. For a discussion of the differences between Canadian GAAP and GAAP as they pertain to Celgar, see Note 10 of the unaudited financial statements of Celgar for the nine month periods ended September 30, 2003 and 2004 and Note 12 of the audited financial statements of Celgar for the year ended December 31, 2003 included elsewhere in this prospectus supplement. For the purposes of this offering and the Senior Note Offering, Celgar has reconciled its accounts to GAAP and will continue to do so for ongoing Mercer consolidated reporting.

The information presented below and the financial statements for Celgar included in this prospectus supplement reflect the entire assets, liabilities and operations of Celgar for the periods and as at the dates indicated. However, we are acquiring only the operating assets of Celgar which, pursuant to the terms of the Acquisition Agreement, do not include the finished goods inventory, receivables, cash on hand and certain insurance claims of Celgar. Further, we are not assuming certain liabilities of Celgar including indebtedness for borrowed money for pre- and post-bankruptcy periods which aggregated approximately C\$1.1 billion at December 31, 2003 and September 30, 2004. See "The Acquisition" and "Selected Historical Financial Information of Celgar" for more information.

Results of Operations

The Celgar mill is a modern NBSK pulp mill that produces high quality NBSK pulp. It has a current annual production capacity of approximately 430,000 ADMTs. In 1998, primarily as a result of the indebtedness incurred by the Celgar mill during an C\$850 million modernization process, its directors assigned Celgar into bankruptcy. KPMG Inc. was appointed trustee in bankruptcy. Immediately thereafter, two large institutional banks appointed KPMG Inc. as the receiver of all the assets and undertakings of Celgar under the security held by the banks. KPMG Inc. has operated the Celgar mill as trustee in bankruptcy since 1998.

The Celgar mill's financial performance depends on a number of variables that impact sales and production costs. Sales and production results are influenced largely by the market price for pulp and paper products and raw materials, the geographic sales mix of products produced and foreign currency exchange rates. Kraft pulp markets are highly cyclical, with prices determined by supply and demand. Demand for kraft pulp is influenced to a significant degree by global levels of economic activity and supply is driven by industry capacity and utilization rates. Primarily as a result of adjustments to inventory levels by Asian buyers in the fourth quarter of 2004, there was weaker demand and lower prices in the Asian market in the 2004 fourth quarter.

The Celgar mill's production costs are influenced by the availability and cost of raw materials, energy and labor, and its plant efficiencies and productivity. The Celgar mill's main raw material is fiber in the form of wood chips and pulp logs for pulp production. Fiber costs are primarily affected by the supply of, and demand for, pulp, which is highly cyclical. Production costs also depend on the total volume of production and plant efficiency. Throughout the later part of 2003, the Celgar mill experienced technical problems relating to a burner misalignment in its lime kiln causing improper heating which resulted in the kiln being shut down on several different occasions. Management at the Celgar mill has determined that the burner misalignment in the lime kiln resulted in additional aggregate costs, primarily related to purchases from third parties, of approximately C\$3.2 million being reflected in cost of sales through to September 2004.

The Celgar mill's financial performance for any reporting period is also impacted by changes in the U.S. dollar to Canadian dollar exchange rate. Changes in currency rates affect the mill's operating results because the price for NBSK pulp is generally based on a global industry benchmark that is priced in U.S. dollars. Therefore, a weakening of the U.S. dollar against the Canadian dollar will generally reduce the amount of Canadian dollar revenues of Celgar's operations. This will adversely affect the Celgar mill's operating margins as the vast majority of its costs are incurred in Canadian dollars. The Celgar mill has not mitigated the effect of currency rate fluctuations, as it has elected not to enter into foreign exchange derivative transactions. As a result, Celgar's product sales, which are primarily invoiced in U.S. dollars, have been at risk to fluctuations in exchange rates from the time such products are sold to the time such products are paid for. Any gain or loss on foreign exchange has been included in Celgar's general and administrative expenses.

Improving pulp demand resulting from improving world economies and the weakening of the U.S. dollar has led to list prices for kraft pulp in the U.S. increasing from an average of approximately \$545 in 2003 to an average of approximately \$670 in the third quarter of 2004. However, such price increases have been largely offset as the U.S. dollar has weakened against the Canadian dollar by approximately 20% during the same period.

Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003 (Unaudited)

In the nine months ended September 30, 2004, net sales increased to C\$214.9 million from C\$207.6 million in the comparative period of 2003, primarily as a result of higher NBSK prices which were partially offset by the continuing decline in the U.S. dollar.

Cost of sales in the period ended September 30, 2004 decreased to C\$167.6 million from C\$182.9 million in the period ended September 30, 2003, primarily as a result of lower sales volume. The reduction in cost of sales was partially offset by an increase in average production costs which was primarily the result of increased fiber costs. Included in cost of sales are costs relating to the burner misalignment in the lime kiln of C\$96,000 for the nine months ended September 30, 2004 and C\$2.0 million for the nine months ended September 30, 2003.

U.S. dollar denominated list pulp price increases were offset by the weakness of the U.S. dollar against the Canadian dollar in the nine months ended September 30, 2004. Average list prices for NBSK pulp in the U.S. were approximately \$600 per ADMT in the first quarter of 2004, approximately \$660 per ADMT in the second quarter of 2004 and approximately \$670 per ADMT in the third quarter of 2004. Pulp sales realizations were C\$735 per ADMT on average in the current period, compared to C\$630 per ADMT in the comparative period of 2003. Pulp sales by volume decreased to 292,233 ADMTs in the current period from 329,253 ADMTs in the comparative period of 2003 primarily as a result of lower shipment volumes to southeast Asia and Europe.

General and administrative expenses decreased to C\$22.8 million in the period ended September 30, 2004 from C\$28.2 million in the period ended September 30, 2003, primarily as a result of a decrease in foreign exchange losses on current receivables and payables. Foreign exchange losses were C\$0.9 million for the nine months ended September 30, 2004, compared to C\$5.0 million for the comparative period in 2003. General and administrative expenses also included C\$0.8 million and C\$1.7 million for the costs of KPMG Inc., as receiver and trustee in bankruptcy for the respective periods.

For the nine months ended September 30, 2004, Celgar reported a loss from operations of C\$127.6 million compared to a loss from operations of C\$32.9 million in the comparative period of 2003. This increase was attributable to a C\$129.2 million write down on property, plant and equipment in connection with the Acquisition.

Depreciation and amortization was C\$22.8 million in the nine months ended September 30, 2004, compared to C\$29.3 million in the comparative period of 2003.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

In the year ended December 31, 2003, net sales increased to C\$271.6 million from C\$249.4 million in the year ended December 31, 2002, primarily as a result of higher sales volumes.

Cost of sales in the year ended December 31, 2003 increased to C\$230.5 million from C\$213.6 million in the year ended December 31, 2002, primarily as a result of higher sales volumes. Included in cost of sales are costs relating to the burner misalignment in the lime kiln of C\$3.1 million in the year ended December 31, 2003 with no corresponding charge in the comparative period in 2002.

U.S. dollar denominated list pulp price increases were mostly offset by an 18% decline in the U.S. dollar against the Canadian dollar in 2003. Average list prices for NBSK pulp in the U.S. were approximately \$490 per ADMT in 2002 and increased to an average of approximately \$550 per ADMT in 2003. Pulp sales realizations were C\$635 per ADMT on average in the current period, compared to C\$623 per ADMT in 2002. Pulp sales by volume increased to 427,860 ADMTs in the current period from 400,101 ADMTs in 2002.

General and administrative expenses increased to C\$38.1 million in the year ended December 31, 2003 from C\$30.6 million in the year ended December 31, 2002, primarily as a result of a required increase in a non-union salary pension plan accrual after an actuarial valuation and an increase in foreign exchange losses on current receivables and payables. Foreign exchange losses were C\$6.0 million for the year ended December 31, 2003, compared to C\$0.8 million for the comparative period. General and administrative expenses also included C\$1.9 million and C\$1.8 million for the costs of KPMG Inc., as receiver and trustee in bankruptcy for the respective periods.

For the year ended December 31, 2003, Celgar reported a loss from operations of C\$36.3 million, compared to a loss from operations of C\$33.8 million in 2002.

Depreciation and amortization was C\$39.2 million in 2003, compared to C\$38.9 million in 2002.

Year Ended December 31, 2002 Compared to the Year Ended December 31, 2001

In the year ended December 31, 2002, net sales increased to C\$249.3 million from C\$246.1 million in the year ended December 31, 2001, primarily as a result of higher sales volumes. In 2001, the Celgar mill was shut down for approximately 50 days for market related reasons.

Cost of sales in the year ended December 31, 2002 decreased to C\$213.6 million from C\$240.0 million in the year ended December 31, 2001, primarily as a result of lower production costs including a decrease in the cost of fiber and lower energy costs.

Average list prices for NBSK pulp in the U.S. were approximately \$525 per ADMT in 2001 and approximately \$490 per ADMT in 2002. Pulp sales realizations were C\$623 per ADMT on average in the current period, compared to C\$674 per ADMT in 2001. Pulp sales by volume increased to 400,101 ADMTs in the current period from 365,132 ADMTs in 2001.

General and administrative expenses increased to C\$30.6 million in the year ended December 31, 2002 from C\$25.9 million in the year ended December 31, 2001, primarily as a result of an increase in insurance premiums, a required increase in a non-union salary pension plan accrual after an actuarial valuation and foreign exchange losses from current receivables and payables. Foreign exchange losses were C\$0.8 million for the year ended December 31, 2002, compared to a foreign exchange gain of C\$1.8 million for the comparative period. General and administrative expenses also included C\$1.8 million and C\$2.0 million for the costs of KPMG Inc., as receiver and trustee in bankruptcy for the respective periods.

For the year ended December 31, 2002, Celgar reported a loss from operations of C\$33.8 million, compared to a loss from operations of C\$58.6 million in 2001.

Depreciation and amortization was C\$38.9 million in 2002, compared to C\$39.0 million in 2001.

BUSINESS

The Company

General

Mercer Inc. is a business trust organized under the laws of the State of Washington in 1968. Under Washington law, shareholders of a business trust have the same limited liability as shareholders of a corporation.

We operate in the pulp and paper business. Our operations are currently located primarily in eastern Germany and, upon completion of the Acquisition, will include western Canada. We currently employ approximately 1,647 people at our German operations and there are currently approximately 420 people employed at the Celgar mill. We believe we will be one of the largest market NBSK pulp producers in the world and will operate three pulp mills with an aggregate annual production capacity of approximately 1.3 million ADMTs:

Rosenthal mill. Our Rosenthal mill is a modern, efficient ISO 9002 certified pulp mill that has an annual production capacity of approximately 310,000 ADMTs and is located near the town of Blankenstein, Germany. The Rosenthal mill is currently the only producer of market NBSK pulp in Germany.

Stendal mill. Our Stendal mill is a new, state-of-the-art, single-line NBSK pulp mill which is designed to have an annual production capacity of approximately 552,000 ADMTs and is situated near the town of Stendal, Germany, approximately 300 kilometers north of the Rosenthal mill.

Celgar mill. The Celgar mill is a modern, efficient ISO 9001 certified pulp mill that has an annual production capacity of approximately 430,000 ADMTs of NBSK pulp and is located near the city of Castlegar, British Columbia, Canada, approximately 600 kilometers east of the port city of Vancouver, British Columbia.

We also own and operate two paper mills located at Heidenau and Fährbrücke, Germany that produce specialty papers and printing and writing papers and, based upon their current product mix, have an aggregate annual production capacity of approximately 70,000 ADMTs.

History and Development of Business

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

Over the last five years to December 31, 2003, we have expended an aggregate of approximately €337.0 million on capital investments at our pulp and paper mills, not including the Stendal project or the Celgar mill, to increase production capacities, improve efficiencies, reduce effluent discharges and emissions and modernize the mills. Such capital investments were financed in large part through government guaranteed term financing and government grants of approximately €94.2 million. For more information about these grants, see "Business Government Financing".

In late 1999, we completed a major capital project which converted the Rosenthal mill to the production of kraft pulp from sulphite pulp, increased its annual production capacity from approximately 160,000 ADMTs to approximately 280,000 ADMTs and, through subsequent minor capital investments and efficiency improvements, increased its annual production capacity to approximately 310,000 ADMTs, and reduced emissions and energy costs. The aggregate cost of the project was approximately €361.0 million.

We completed financing arrangements and commenced construction of the Stendal mill in August 2002. The aggregate cost of the Stendal project is approximately €1.0 billion. Construction of

the Stendal mill was completed substantially on its planned schedule and budget in the third quarter of 2004 and the mill is currently in the start-up phase. For more information about the Stendal project, see " Stendal Pulp Mill Project and Financing".

Commencing in 1998, we implemented a strategy to focus on our core operations and rationalize assets that either were not part of our core operations or did not provide the desired level of return. As a result, between 1998 and 2000, we took a charge of €17.9 million relating to our paper operations and sold four paper mills that produced packaging, carton and printing papers located at Greiz, Raschau, Trebsen and Hainsberg, Germany.

The sale of these paper mills was the result of a strategic decision to withdraw from commodity paper grades produced principally from waste paper where we had little market share and, we believed, limited potential for long-term profitability. We continue to operate and upgrade the Heidenau and Fährbrücke paper mills as they principally produce niche products.

We reorganized our interest in Landqart, which owns a specialty paper mill in Switzerland, at the end of 2002 by transferring a 20% interest to a Swiss bank and exchanging the other 80% interest for an indirect 39% minority interest through a limited partnership on a non-cash basis. See "Business Our Products Paper".

Organizational Chart

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

(1) Certain wholly owned intermediate holding companies are not shown.

Competitive Strengths

Our competitive strengths include the following:

Modern Low Cost NBSK Pulp Mills. Upon completion of the Acquisition, we will operate three large, modern NBSK pulp mills and are a low cost NBSK pulp producer. The significant capital investments at the Rosenthal mill have resulted in a facility which ranks in the lowest cost quartile for NBSK pulp delivered to Europe. We expect our overall cost structure to improve because the Stendal mill is designed to have even lower production costs than the Rosenthal mill. Based on an industry survey, we believe that the Celgar mill ranks in the second quartile in North America on a manufactured cost basis for NBSK pulp. The relative age and production capacity of our NBSK pulp mills provide us with certain cost advantages over many of our competitors including lower maintenance capital expenditures.

High Quality NBSK Pulp Products. Our pulp mills produce high quality NBSK pulp which is a premium grade of kraft pulp. Our Rosenthal mill continues to increase the proportion of its sales of reinforcement NBSK pulp, which is used to produce stronger papers and generally obtains the highest price. The Stendal mill is similarly expected to produce a high quality NBSK pulp product, although from a slightly different species mix, resulting in a complementary product more suitable for different end uses. We believe that the pulp produced at the Celgar mill is known for its excellent product characteristics and the mill is a long-established supplier to paper producers in Asia.

Close Proximity to Customers. We are the sole kraft pulp producer and the only producer of market pulp in Germany, which is the largest pulp import market in Europe. Due to the proximity of the Rosenthal and Stendal mills to most of our European customers and the new member countries of the European Union, we benefit from lower transportation costs relative to our major competitors. As the Celgar mill is located in western Canada, it is well situated to serve Asian and North American customers. We believe our ability to deliver pulp on a timely basis enhances customer satisfaction and has made us a preferred supplier for many customers.

Stable and Abundant Fiber Supply. There is a significant amount of high-quality fiber within a close radius of each of our pulp mills. This fiber supply, combined with our purchasing power, provides us with an ability to enter into contracts which have relatively stable prices and volumes.

Strategy

Our corporate strategy is to create shareholder value by focusing on the expansion of our asset and earnings base through organic growth and acquisitions primarily in Europe and North America. We pursue organic growth through active management and targeted capital expenditures designed to produce a high return by increasing production, reducing costs and improving quality. We seek to acquire interests in companies and assets in the pulp and paper industry and related businesses where we can leverage our experience and expertise in adding value through a focused management approach. Key features of our strategy include:

Focusing on NBSK Market Pulp. We focus on NBSK pulp because it is a premium grade kraft pulp known for its strength which obtains the highest price relative to other kraft pulps. Although demand is cyclical, worldwide demand for kraft market pulp has grown at an average of approximately 3% per annum over the last ten years with higher growth rates in certain markets such as eastern Europe and Asia. We do not believe there are any significant new NBSK pulp production capacity increases coming online in the next several years due in part to fiber supply constraints and high capital costs.

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

Improving Efficiency and Reducing Operating Costs. We focus on increasing the productivity and operating efficiency of our production facilities through cost reduction initiatives, including targeted capital investments. We seek to make high return capital investments that increase production and operating efficiency at our production facilities, reduce costs and improve product quality. We also seek to reduce operating costs by better managing certain operating activities at our facilities such as fiber procurement, sales and marketing activities, and we intend to further coordinate these activities at our pulp facilities to realize on potential synergies among them. In particular, we believe there are a number of opportunities to reduce the operating costs, increase production and improve the financial results of the Celgar mill.

Enhancing Customer Relationships. We focus on continually improving our marketing and distribution capabilities to enhance our customer relationships and capitalize on our geographic diversification. We seek to differentiate ourselves from our competitors by consistently delivering high quality products to our customers on a global basis. We intend to coordinate the marketing and distribution activities at our pulp mills to better service our customers.

The Pulp Industry

General

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

The market value of kraft pulp depends in part on the fiber used in the production process. There are two primary species of wood used as fiber: softwood and hardwood. Softwood species generally have long, flexible fibers which add strength to paper while fibers from species of hardwood contain shorter fibers which lend bulk and opacity. Prices for softwood pulp are generally much higher than for hardwood pulp. As at September 30, 2004, there was an approximately \$110 per ADMT difference in their list prices in Europe. Currently, the kraft pulp market is roughly evenly split between softwood and hardwood grades. Most uses of market kraft pulp, including fine printing papers, coated and uncoated magazine papers and various tissue products, utilize a mix of softwood and hardwood grades to optimize production and product qualities. In recent years, production of hardwood pulp, based on fast growing plantation fiber primarily from Asia and South America, has increased much more rapidly than that of softwood grades that have longer growth cycles. As a result of the growth in supply and lower costs, kraft pulp customers in recent years have substituted some of the pulp content in their products to hardwood pulp. Counteracting customers' increased proportionate usage of hardwood pulp has been the requirement for strength characteristics in finished goods and paper and tissue makers focus on higher machine speeds and lower basis weights for publishing papers which also require the strength characteristics of softwood pulp. We believe that the ability of kraft pulp users to further substitute hardwood for softwood pulp is limited by such requirements.

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

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

Pulp Markets

Producers ranging from small independent manufacturers to large integrated companies produce pulp worldwide. In 2003, more than 130 million ADMTs of kraft pulp were converted into printing and writing papers, tissues, cartonboards and other white grades of paper and paperboard around the world. Approximately 65% of this pulp was produced for internal purposes by integrated paper and paperboard manufacturers, and approximately 35% was produced for sale on the open market.

In 2003, total worldwide consumption of market pulp was approximately 50 million ADMTs, comprised of various types of market pulp as illustrated below:

Global Market Pulp Shipments

Source: Pulp and Paper Products Council

Although demand is cyclical, worldwide demand for kraft market pulp has grown at an average rate of approximately 3% annually over the last ten years. Over the last ten years, hardwood kraft pulp production has increased at a faster rate than softwood kraft pulp production, at 5% and 2%, respectively. As such, hardwood pulp now comprises approximately 42% of total market pulp shipments, only slightly less than softwood, an increase from 35% in the early 1990s. This higher growth rate is the result of significant capital investment in new capacity in tropical regions where forest plantations exhibit higher growth rates, such as Indonesia and South America. The rapid growth rates result in shorter fibers, with resulting pulp qualities of softness, bulk and opacity. NBSK pulp, which provides paper makers with strength, allows for increased use of inert fillers, clays and coatings as well as reducing breakage on new high speed paper and printing machines. We believe that the substitution of softwood by hardwood pulp is limited, and that NBSK pulp will continue to act as the benchmark grade within the pulp markets. The growth rate for NBSK pulp reflects this continuing demand, with growth rates higher than the general softwood kraft group. The following chart illustrates the worldwide NBSK market pulp demand for the specified periods:

Worldwide NBSK Market Pulp Demand

Source: Pulp and Paper Products Council

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Western Europe accounts for approximately 40% of global market pulp demand with a growth rate of approximately 2% annually over the past ten years. Approximately 18 million ADMTs of market pulp were consumed in western Europe in 2003, of which approximately six million ADMTs were comprised of NBSK pulp. The following map provides an overview of the estimated European trade flows of market pulp in 2003, with Europe importing substantial quantities of pulp from the Americas:

2003 Trade Flows in Pulp for Europe (CEPI) ⁽¹⁾ (thousands of ADMTs)

Source: Confederation of European Paper Industries ("CEPI")

- (1) Europe (CEPI) means the European Union countries, Norway and Switzerland.
- (2) Europe (non-CEPI) means all European countries other than Europe as defined above.

Within Europe, Germany, with its large economy and sizable paper industry, is the largest pulp market and consumed approximately six million ADMTs of market pulp in 2003 relying largely on imports from North America and Scandinavia. Approximately 61% of the market pulp consumed in Germany in 2003 was kraft pulp. In 2003, the top five importing countries in continental Europe were as follows:

Market	Imports of Kraft Pulp From	
	Europe ⁽¹⁾	Outside Europe
	(thousands of ADMTs)	
Germany	2,346	1,469
Italy	926	1,976
France	823	1,078
United Kingdom	435	737
Netherlands	458	256

- (1) Includes European Union countries, Norway and Switzerland.
Source: Council of European Paper Industries

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Demand for market pulp in Asia (excluding Japan) has been growing at approximately 9% annually over the past ten years and currently accounts for approximately 30% of global demand. Approximately 13 million ADMTs of market pulp were consumed in Asia (excluding Japan) in 2003, of

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which approximately 2.3 million ADMTs were comprised of NBSK pulp. This demand growth has been driven both by increasing per capita consumption combined with the mandated closure of numerous small, often non-wood based, pulp facilities in China. Canada is the largest exporter to this region, supplying approximately three million ADMTs of market pulp in 2003, approximately two million of which were comprised of NBSK pulp. Additionally, Japan consumed approximately three million ADMTs of market pulp in 2002, the latest year for which data is available, of which approximately 25% was comprised of NBSK pulp. The following chart illustrates the worldwide total market pulp demand for the specified periods:

Worldwide Total Market Pulp Demand

Source: Pulp and Paper Products Council

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

The consumption/capacity ratio, excluding Indonesian and eastern European pulp producers, was approximately 89% in 2001, approximately 91% in 2002 and approximately 93% in 2003. We expect the long lead time and significant capital investment required to bring new pulp mills on stream to limit growth in industry capacity in the next few years.

Kraft Pulp Pricing

Global economic conditions, changes in production capacity, inventory levels, and currency exchange rates are the primary factors affecting NBSK pulp list prices. Canada and western Europe currently represent approximately 50% and 40%, respectively, of global NBSK pulp capacity while list prices are denominated in U.S. dollars. The following chart illustrates the average annual European NBSK list pulp prices since 1990:

Average Annual European NBSK List Pulp Prices

Source: Pulp and Paper Week

The average annual European list prices for NBSK pulp between 1990 and 2003 ranged from a low of approximately \$444 per ADMT in 1993 to a high of approximately \$875 per ADMT in 1995.

The 1995 price peak was followed by a steep decline as inventory levels for North American and Scandinavian, or "Norscan", producers grew to over 2.5 million ADMTs by early 1996. Norscan producers currently produce a majority of the market NBSK pulp sold in North America and Europe and inventory levels held by Norscan producers are considered an industry benchmark in determining industry inventory levels. Between 1996 and 1999, list pulp prices remained relatively low due in part to the Asian financial crisis which began in late 1997.

Prices started to recover in 1999 due to a combination of factors including a recovery in the Asian economy, the shutdown of unprofitable mills or older mills in need of environmental upgrades and a decline in capacity expansion. This contributed to tightening inventory levels among Norscan producers, which fell to approximately 1.1 million ADMTs in June 2000, resulting in list prices increasing to an average of approximately \$710 per ADMT in the fourth quarter of 2000. However, the decline of the American and major European economies in 2001 caused a sharp reduction in paper demand. As a result, Norscan pulp inventories rose to a high of approximately two million ADMTs in early 2001 and list price levels eroded to an average of approximately \$460 per ADMT in late 2001. Inventory levels ranged between approximately 1.3 million and 1.9 million ADMTs in 2002, and list prices averaged approximately \$463 per ADMT in 2002. The weakening of the U.S. dollar against the Euro and other major currencies and an increase in demand resulting from improving American and major European

economies in 2003 resulted in list prices for kraft pulp in Europe increasing to approximately \$560 per ADMT in December 2003 despite relatively high inventory levels. List prices for kraft pulp in Europe continued to strengthen in the first half of 2004 due to the relatively weak U.S. dollar and improving world economies. List prices increased to approximately \$660 per ADMT in July 2004, before falling to approximately \$585 per ADMT in October 2004 and subsequently recovering to approximately \$625 per ADMT in December 2004. A producer's sales realizations will reflect customer discounts, commissions and other items and it is likely that prices will continue to fluctuate in the future.

The Manufacturing Process

The following diagram provides a simplified description of the kraft pulp manufacturing process at the Rosenthal, Stendal and Celgar mills:

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

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

Cooked pulp flows out of the digester and is washed and screened to remove most of the residual spent chemicals, called black liquor, and partially cooked wood chips. The pulp then undergoes a series of bleaching stages where the brightness of the pulp is gradually increased. Finally, the bleached pulp is

sent to the pulp machine where it is dried to achieve a dryness level of more than 90%. The pulp is then ready to be baled for shipment to customers.

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

The heat produced by the recovery boiler is used to generate high-pressure steam. Additional steam is generated by a power boiler through the combustion of biomass consisting of bark and other wood residues from sawmills, residue generated by the effluent treatment system and natural gas. The steam produced by the recovery and power boilers is used to power a turbogenerator to generate electricity, as well as to provide heat for the digesting and pulp drying processes.

The Paper Industry

The paper industry is global in nature with many international, national and regional producers competing over many different product lines. Prices and profitability in the paper industry are driven primarily by global supply and demand. Demand is strongly influenced by global and regional levels of economic activity. Supply is determined by industry capacity and operating rates. In general, the paper industry has experienced periods of supply and demand imbalance. When demand increases, prices rise, which leads producers to increase their capacity and operating rates. As supply increases in response, price competition increases, driving prices lower.

We produce principally specialty papers and printing and writing papers. The specialty papers that we produce are comprised of coated and uncoated wallpaper base, non-woven wallpaper base and greaseproof paper.

Wallpaper can be coated with an agent to enhance its appearance and printing capability. In addition, non-woven wallpaper contains a certain proportion of synthetic fibers so that it does not expand when wet, paste can be applied to the wall instead of the wallpaper and it can be easily torn from the wall, or drystripped. Demand for wallpaper is related to activity in the construction and refurbishing industries, which have been relatively strong due to low interest rates in most industrialized countries. Non-woven wallpapers are the fastest growing category of wallpaper.

Greaseproof paper is a consumer oriented product that can be used for, among other things, baking and the packaging of food products such as fast foods.

Printing and writing papers which we produce consist of only uncoated woodfree papers. Woodfree papers generally contain less than 10% mechanical pulp. Uncoated woodfree papers can be finished to enhance their surface and are often used to print less costly products.

Raw Materials

Our mills are situated in regions which offer an ample and stable supply of fiber. The fiber consumed by our pulp mills consists of wood chips produced by sawmills and pulp logs, which are cyclical in both price and supply. Wood chips are small pieces of wood used to make pulp and are a product of either wood waste from sawmills or pulp logs processed, or chipped, especially for this purpose. Pulp logs consist of lower quality logs not used in the production of lumber. The costs of wood chips and pulp logs are primarily affected by the supply and demand for lumber.

Rosenthal mill

The wood chips for the Rosenthal mill are sourced from approximately 60 sawmills located in the States of Bavaria and Thuringia within a 150 kilometer radius of the Rosenthal mill. Within this radius, the Rosenthal mill is the largest consumer of wood chips. Given its location and size, the Rosenthal mill is the best economic outlet for the sale of wood chips in the area. In 2003, the Rosenthal mill consumed approximately 1.7 million cubic meters of fiber. Approximately 66%, or approximately 1.1 million cubic meters, of such consumption was in the form of sawmill wood chips. The balance of approximately 34%, or approximately 0.6 million cubic meters, was in the form of pulp logs. Approximately 85% to 90% of the fiber consumed by the Rosenthal mill is spruce and the remainder is pine. We believe the Rosenthal mill's fiber costs have historically been among the lowest for European pulp producers. The Rosenthal mill's transportation division, which operates approximately 50 trucks, handled approximately 50% of our wood chip deliveries to the mill in 2003. While fiber costs and supply are subject to cyclical changes largely in the sawmill industry, we expect that we will be able to continue to obtain an adequate supply of fiber on reasonably satisfactory terms for the Rosenthal mill due to its location and our long-term relationships with suppliers. We have not historically experienced any fiber supply interruptions at the Rosenthal mill.

Wood chips for the Rosenthal mill are normally sourced from sawmills under one year or quarterly supply contracts with fixed volumes, which provide for price adjustments. In 2003, we entered into a three-year agreement with one of our existing wood chip suppliers for the supply for the Rosenthal mill of approximately 500,000 cubic meters of wood chips annually until 2006. Pulp logs are partly sourced from the state forest agency in Thuringia on a contract basis and partly from private holders, on the same basis as wood chips. We organize the harvesting of pulp logs sourced from the state forest agency in Thuringia after discussions with the agency regarding the quantities of pulp logs that we require.

The Rosenthal mill's fiber requirements were historically procured principally by SCA Holz, a large wood supply company. Our agreement with SCA Holz expired in April 2003 and has not been renewed. We have organized our own internal wood procurement department to handle and source the fiber requirements for the Rosenthal mill. Five people are employed in the department currently. The department will continue to procure fiber for the Rosenthal mill from many of the same sources and under similar terms as under our agreement with SCA Holz. The department also assisted in sourcing fiber for the start-up of the Stendal mill. We expect to coordinate the fiber procurement for the Rosenthal and Stendal mills. We believe that handling our own fiber procurement will reduce our operating costs over the long-term due to the elimination of third party fees paid for sourcing fiber.

Stendal mill

The fiber consumed by the Stendal mill consists of wood chips and pulp logs. When fully operational, the Stendal mill is expected to consume approximately 2.8 to 3.0 million cubic meters of fiber annually. The core wood supply region for the Stendal mill includes most of the northern part of Germany within an approximately 240 kilometer radius of the mill. The wood supply potential in this core region is not yet fully utilized and we expect that it should be able to supply 80% of all of the fiber needed by the mill. We expect to obtain the balance primarily from southwestern and southern Germany. The fiber base in the planned wood supply area for the Stendal mill consists of approximately 80% pine and 20% spruce and fir. We expect approximately 20% of the fiber consumed by the Stendal mill to be in the form of sawmill wood chips and approximately 80% in the form of pulp logs. The Stendal mill has sufficient chipping capacity to fully operate using solely pulp logs, if required. We expect to source wood chips from sawmills within an approximately 360 kilometer radius of the Stendal mill. We expect to source pulp logs partly from private forest holders and partly from state forest agencies in Thuringia, Sachsen-Anhalt and Brandenburg. In 2003, Stendal commenced putting into place definitive supply arrangements similar to those of the Rosenthal mill. We have currently arranged for approximately 45% of the fiber requirements for the Stendal mill for 2005.

When fully operational, the Stendal mill is expected to be the largest consumer of wood chips in Germany and, together with the Rosenthal mill, provide the best economic outlet for the sale of wood chips in eastern Germany.

Stendal has established its own wood procurement organization to handle the fiber requirements for the Stendal mill. Currently, there are approximately 87 people employed in this division. This division focuses on three principal activities, being wood procurement and sales, harvesting, and transportation. The procurement and sales main activity is to procure the required wood chip and pulp log assortments for the mill's annual production. In conjunction with this activity, it may also procure higher quality sawlogs, either through harvesting or through purchases that it can sell or trade with others for wood chips in order to optimize the fiber mix. When fully operational, we expect these activities to employ up to 15 people. The harvesting activities focus on acquiring up to approximately 800,000 cubic meters per annum of harvestable timber, of which approximately 75% is expected to be pulp logs and the balance likely to be higher quality logs that could be sold or traded to third parties for wood chips. We expect that approximately half of this volume may be harvested directly by us and the other half would be contracted out to third parties. When fully operational, we expect to engage up to 55 people in this division. Transportation activities focus on managing, controlling and optimizing shipping and flows of pulp logs to the mill. When fully operational, we expect that the transportation activities may employ up to 40 people.

When the Stendal mill is fully operational, we expect to be the largest consumer of wood chips and pulp logs in Germany. We intend to coordinate and integrate the wood procurement activities for the Rosenthal mill and the Stendal mill to realize on a number of potential synergies between them. These include reduced overall personnel and administrative costs, greater purchasing power and coordinated buying and trading activities. We also believe such coordination and integration of fiber flows will allow us to optimize transportation costs, and the species and fiber mix for both mills.

Celgar mill

The Celgar mill has a secure supply of high quality fiber that it purchases from a number of Canadian and U.S. suppliers. When operating at full capacity, the Celgar mill's annual fiber requirements are approximately 2.4 million cubic meters. Two sources of fiber are used to meet this demand: chips purchased from nearby sawmills and chipping facilities, and roundwood pulp logs purchased from local logging contractors. All of the Celgar mill's fiber is sourced externally with approximately 90% covered under chip contracts and the remaining 10% coming from the roundwood pulp logs processed through its woodroom.

Celgar has entered into long and short-term chip supply agreements with approximately 30 different suppliers from British Columbia, Canada and the U.S. for a total of approximately 2.2 million cubic meters (excluding chips from its own woodroom). This represents approximately 90% of total annual fiber requirements at the mill. Celgar's woodroom supplies the remaining chips to meet the Celgar mill's requirements. The Canadian chip supply agreements contain terms that index the price of the chips to NBSK pulp pricing and therefore the chip costs are correlated with Celgar's net sales. The majority of the agreements are for periods ranging between two and six years. Several of the longer-term contracts are so-called "evergreen" agreements, where the contract remains in effect until one of the parties elects to terminate. Termination requires a minimum of two, and in some cases, five years written notice. Certain non-evergreen long-term agreements provide for renewal negotiations prior to expiry. We expect substantially all of the chip supply agreements which have been entered into by Celgar to be assigned to us or to renegotiate new agreements on substantially the same terms. Celgar has contracts with three sawmills, which are all owned by the same parent. These sawmills comprise approximately 25% of the Celgar mill's total fiber supply. Two of these chip agreements each remain in effect until December 31, 2008 and thereafter, if not extended, continue, subject to volume reductions, indefinitely, subject to termination by either party upon two years' prior notice. The third agreement is an evergreen agreement that remains in effect until terminated upon five years' prior notice. The chip agreements each contain provisions that may vary chip volume delivery commitments upon the happening of certain events.

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Except for occasional minor purchases from smaller suppliers, the balance of Celgar's fiber requirements is met by the production of chips from its own woodroom. Currently the woodroom is effectively operating a 40 hour/week schedule to supply chips to the Celgar mill. To secure the volume of pulp logs required to meet its requirements, Celgar has entered into annual pulp log supply agreements with 20 to 30 different suppliers, many of whom are also Celgar's contract chip suppliers. The woodroom is capable of running additional shifts and has historically operated in this fashion. Additional volumes of pulp logs are available to ramp up woodroom operations by up to 50%. All of the pulp log agreements can be terminated by either party for any reason, upon seven days' written notice.

In addition to existing agreements, opportunities exist for the Celgar mill to secure additional fiber from mills in both Canada and the U.S. In the recent past, Celgar has purchased fiber from other suppliers. Celgar has flexibility in the selection and choice of suppliers, thus assuring continuity of supply as well as the ability to mix species when needed.

Paper mills

The fiber used by the paper mills consists of pulp and waste paper (recycled paper), which are cyclical in both price and supply. The cost of this fiber is primarily affected by the supply and demand for paper and pulp. In 2003, approximately 85%, or approximately 64,036 ADMTs, of the fiber consumed by our paper mills was in the form of market pulp and chemical additives. Market pulp and chemical additives are available at market prices from various suppliers throughout Europe. The balance of approximately 15%, or approximately 11,621 ADMTs, of the fiber consumed by our paper mills was in the form of waste paper. Germany has extensive waste paper recycling and collection laws which result in a readily available supply. The cost of lower grade waste paper is currently relatively low in comparison to virgin pulp. We have not historically experienced any fiber supply interruptions at our paper mills.

Pulp Cash Production Costs

The Rosenthal mill commenced kraft pulp operations in late 1999. As production and sales ramped-up and increased, efficiencies were achieved within the mill operations, resulting in lower per unit costs. Cash production costs for the Rosenthal mill for the periods indicated below are as follows:

Costs	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003 ⁽¹⁾	2004 ⁽¹⁾
	(per ADMT)			(unaudited)	
Fiber	€ 184	€ 178	€ 178	€ 178	€ 171
Labor	57	54	51	53	54
Chemicals	48				