WestPeak Research

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Mercer International Inc. (MERC:NASDAQ)

Consumer Goods - Pulp & Paper Products

Company Profile

Mercer International [MERC:NASDAQ] is a global pulp company specializing in the production of northern bleached softwood kraft (NBSK) pulp, which is used in a variety of paper and tissue products. Mercer also sells biochemical and bioenergy products, both by-products of the pulp production process. They operate in Canada and Germany through three mills: Rosenthal, Stendal and Celgar. Over 50% of revenues are attributable to European sales, while growing Chinese business represents 26% of sales.

A Growing Company

Recent capital investments in biochemical and bioenergy production provide a safeguard against NBSK volatility, while increasing opportunity in China proposes attractive growth potential for Mercer International. Combined with recently delevered operations, a new dividend and a dominant position in European markets, Mercer International shows significant potential for future growth.

Valuation & Recommendation

Valuation of Mercer International was conducted through a discounted cash flow analysis (DCF) and a comparable valuation. The mix of the DCF implied value and comparable valuation yields a target price of $13.75, well above the current trading price.

We recommend a Buy rating for Mercer International. Conservative estimates in our valuation still yielded results suggesting close to a 70% upside, and enticing opportunities in the biochemical, bioenergy and Chinese NBSK markets ensure that Mercer International offers investors a growing, well positioned company, at a discounted price.

Braeden Price, Analyst
Bachelor of Commerce 2018

Equity Research	Canada
Price Target	**CAD$ 13.75**
Rating	Buy
Current Share Price, close	CAD $8.11
Total Return	69.5%

Key Statistics	
52 week H/L	$15.69/$7.95
Market Capitalization	$540M
Net Debt	$532.8M
Enterprise Value	$1072.7M
Net Debt/Enterprise Value	49.7%
Diluted Shares Outstanding	64.5M
Free Float %	67.27%
Dividend Yield	1.41%
LTM P/E	7.27x
LTM EV/EBITDA	4.77x

WestPeak's Forecast

	2015E	2016E	2017E
Revenue	$1.08B	$1.19B	$1.20B
EBITDA	$243M	$262M	$278M
EBIT	$173M	$195M	$210M
Net Income	$146M	$89M	$97M

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Business Overview

Products

A) NBSK Pulp

Mercer International produces and sells northern bleached softwood kraft (NBSK) pulp through its three mills: Stendal (Germany), Rosenthal (Germany), and Celgar (BC, Canada). All three mills are capable of producing a total of 1,540,000 ADMTs (air dried metric tonnes) of NBSK pulp, with the Stendal mill responsible for 45% of production (660,000 ADMTs), Rosenthal responsible for 24% (360,000 ADMTs) and Celgar responsible for 31% (520,000 ADMTs). NBSK pulp is used to produce many everyday items, such as printing paper and tissue paper.

B) Bioenergy

Necessary for competitive production in today's market, Mercer International produces its own energy by burning hog fuel, the mixture of wood chips and shavings that are not of fine enough quality to be used in the pulp process. Excess energy generated is sold for additional income as bioenergy. The Stendal mill exports the most energy, at 509,000MWh ($56.8M, 2014) while Rosenthal and Celgar sold 178,000MWh ($21.9M, 2014) and 120,000MWh ($10.1M, 2014) respectively.

B) Biochemicals

The chemicals used to convert wood chips to pulp are processed and recycled within each mill, with the by-product, tall oil, being refined at an internal tall oil plant and sold as biochemicals. The remaining chemicals are reused in the next pulp production cycle.

Cost Structure

A) Labour

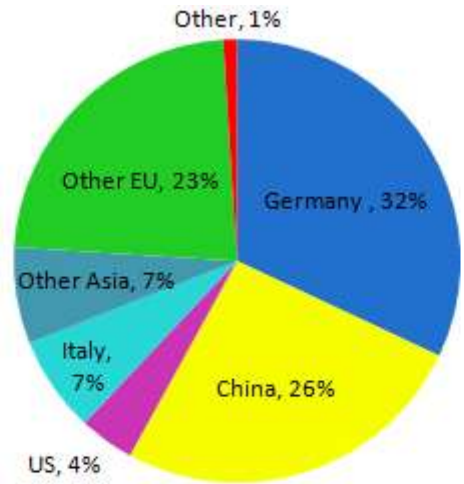
Labour costs have historically remained relatively stable for Mercer International, with labour representing only 11% of each NBSK ADMT. A recent 85 man workforce reduction at the Celgar mill pushed labour costs lower, incurring a $5M restructuring expense, but saving $8M-$10M annually. This reduction brings Mercer's workforce more in line with similar mills.

B) Fiber

The largest production cost involved in each NBSK ADMT is the fiber, the wood chips used to create pulp. This cost represents 62% of each ADMT's costs. Fiber for Rosenthal is typically sourced from sawmills under one year contracts, while Stendal sourced 30% of its fibre from sawmills and 70% from pulp logs (wood harvested for the sole purpose of pulp production). Celgar sources fiber from a large variety of suppliers across US and Canada, with 22% sourced from Celgar's internal processing of pulp logs.

Customer Concentration

Germany is Europe's largest NBSK market, and Rosenthal and Stendal's position in Germany allow for easy distribution to consumers in the European market. German sales alone account for 32% of Mercer's revenue, with a further 30% of sales attributable across Europe. Celgar, located in BC, Canada, exports primarily to China and other regions of Asia, with smaller exports being made to the US. China alone is responsible for 26% of Mercer International's revenue, and is expected to grow in coming years as disposable income levels rise and China's domestic NBSK mills continue to shut down. NBSK is sold primarily to tissue manufacturers, printing paper producers and specialty paper manufacturers. Traditionally, 60% of NBSK sales were to printing paper producers while a mere 17% were to tissue manufacturers. Today however, tissue producers represent 40% of NBSK demand, and printing paper producers have shrunk to 30%, likely due to global digitization.

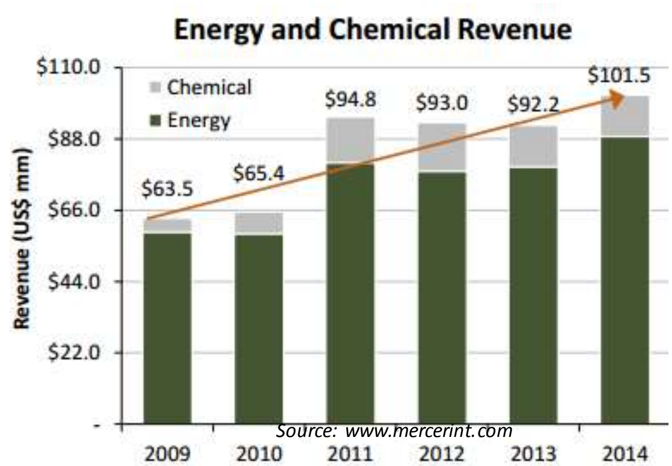


NBSK pulp prices differ from country to country. US prices average at $980/ADMT, while European markets call for $820/ADMT. China prices NBSK at $650/ADMT; this is a significant drop from previous years' prices ($850+/ADMT). Macroeconomic shifts suggest upward price pressures in China, however.

Corporate Strategy - Organic Growth

1. Expand Biochemical and Bioenergy Divisions

The NBSK industry as a whole faces risks ranging from substitution to global digitization, so the relatively stable bioenergy and biochemical market provides a safeguard against any possible shifts in NBSK demand. Previously, only the Stendal mill was capable of refining and selling tall oil as it was the only mill with a tall oil plant, generating $11.9M in biochemical sales. In Q4 2014 however, Mercer International completed the installation of a second tall oil plant at Rosenthal for $3.7M, expecting an additional $3.5M per year from biochemical sales.



Along with the tall oil plant at Rosenthal, Mercer also completed the installation of a 46MW turbine at the Stendal mill, producing an additional 109,000MWh of surplus electricity.

2. Increase Production Efficiency

Decreasing unnecessary operating costs is a fundamental aspect of Mercer International's strategy. Capital investments in mill upgrades represent a majority of capital expenditures-- In 2014, approximately $12M (34% 2014 Capex) was spent on an automated chip reclamation project at the Rosenthal mill, while a total of $49M was spent on "Project Blue Mill", an initiative to debottleneck production and increase efficiency at the Stendal mill. At Celgar, a new chip screening project and a logistics warehousing project totalled $9.2M.

Due to high fixed costs, Mercer's operating margin has been volatile in the last five years. In order to soften damage from possible low production volume, investments such as Project Blue Mill increase per-tonne margins. This strategy has been successful; Mercer's operating margin has increased by 12% since 2013.

2014 Transitions

In 2014, Mercer International underwent significant changes. Jimmy Lee, Mercer's CEO since 1992, became Executive Chairman of the Board, with David Gandossi, Mercer's CFO, becoming the new CEO. In addition, Mercer International acquired full economic interest in the Stendal mill, bringing mill ownership to 100% across all three mills. Mercer International also completed a refinancing of its operations through $650M in senior notes ($250M 7% 2019 Senior Note and $400M 7.5% 2022 Senior Note). This refinancing paid off Mercer's previous 2017 9.5% Senior Note, as well as the $500M Stendal Loan facility. As a result, Mercer International's Net Debt/EBITDA was lowered to 2.2x, from 3.2x. Lastly, Mercer commenced their first dividend of $0.115/share, bearing a dividend yield of 1.41%.

Mercer International vs Government of Canada Proceedings

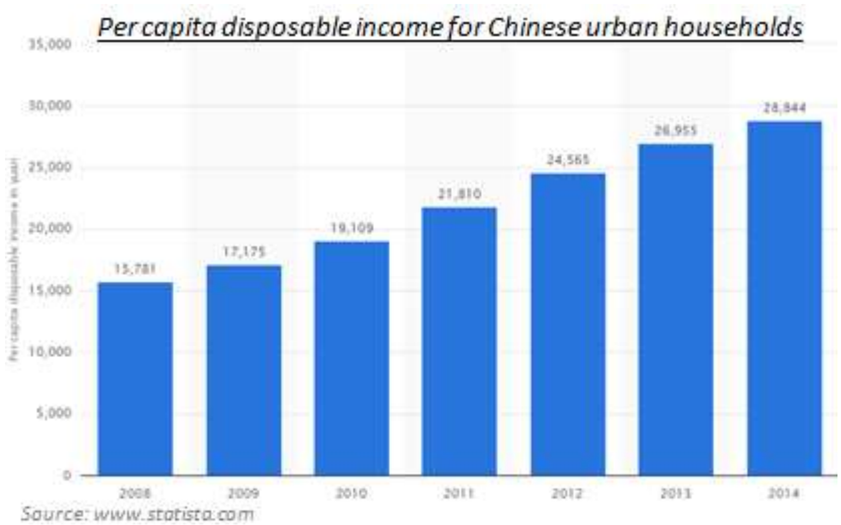
The Celgar mill is both a producer and consumer of electricity, and to take advantage of this, Mercer entered an agreement with FortisBC in 2008 to purchase electricity at a lower, embedded cost. This allowed Celgar to sell its produced electricity at a higher price to third party consumers, a strategy many other BC mills have engaged in. FortisBC is supplied electricity from BC Hydro at this lower embedded cost through an agreement, which it passes along to its consumers. Soon after Mercer entered the agreement with FortisBC, BC Hydro and the BC Utilities Commission made an amendment to the FortisBC-BC Hydro agreement, restricting access to this electricity from consumers who also produce their own electricity. Other pulp mills in BC have entered agreements with BC Hydro to purchase electricity at lower costs, but similar agreements with the Celgar mill have been blocked by the BC Utilities Commission, claiming it violated the aforementioned amendment. Thus, the Celgar mill became the only mill in BC to be forced to generate all of its electricity internally, causing annual losses of $19M in lost revenue.

In 2012, Mercer International filed a claim against the Government of Canada under NAFTA violations, seeking damages of $250M. The summer of 2016 will see hearings in Washington, and following that, the arbitration panel will have up to nine months to reach a decision.

Macro Environment

Demand for NBSK pulp is driven by the two primary end products, specialty paper (such as cigarette paper and decor paper), and tissue paper. Due to NBSK's strong fibres, the pulp is an essential input for these products. Demand for NBSK pulp for use in tissue paper has grown steadily since 2003, much of which can be attributed to a growing disposable income level in China, one of the largest regions of demand in the pulp industry.

China - Rising Disposable Income



China's disposable income level has continued to rise since the early 2000s, suggesting a growing middle class and an increasingly consumption driven economy. This rise in income increases demand for hygiene products, implying increasing pressure on China's tissue factories. As emissions policies tighten however, Chinese NBSK mills have been forced to shut down, decreasing China's domestic supply of NBSK pulp. This has forced Chinese tissue manufacturers to import pulp from abroad, primarily from Canadian mills such as Celgar. These forces have placed upward pressure on Chinese NBSK prices, which has recently been priced at $650/ADMT. This represents a significant opportunity for Mercer International to grow its business in China.

Cyclical Market

The NBSK pulp market is cyclical, and is driven by the balance between global supply and demand. As stated in Mercer International's 2014 annual report, supply and demand are generally balanced when global bleached softwood kraft (BSK) inventories reach 30 days' supply, which is where inventory currently sits.

Rising Fiber Costs

Fiber is the primary production cost for NBSK pulp mills, and is largely affected by demand for lumber. However, recent initiatives by European governments promote wood chips as a carbon neutral energy source, creating higher demand for fiber in Europe- Rosenthal and Stendal's main source for fiber. In BC, lower lumber production decreased wood chip supply, resulting in higher prices for Celgar's fiber. This reflects the current global sentiment for the lumber industry; prices continue to climb as supply decreases due to global economic hardships. In coming years, Mercer International may be subject to higher fiber costs across its three mills.

Competition

The pulp industry is highly competitive by nature. With low product differentiation, NBSK pulp is considered a commodity, and NBSK pulp producers' primary tool to attract new business is price. Combined with the fact that there is no globally dominant NBSK supplier, producers who are able to offer lower prices will be able to acquire new business quicker than others.

New entrants into the pulp market face significant costs, as the construction of a pulp mill may cost in the $1B+ range. Developing and maintaining a transportation and distribution network is also costly, and it is unlikely that new entrants will realize high enough returns without previous relationships with NBSK consumers.

Mercer International competes against large companies with greater resources and financial flexibility. It is possible that competitors may be able to invest in larger projects than Mercer International is capable of to reduce manufacturing overhead. However, Mercer maintains a competitive advantage through their dominant position in Germany and European markets. As the largest NBSK mills in Germany, Mercer International is able to dominate the European market, while Celgar's position in BC, Canada allows for efficient exportation to China, where demand is expected to grow. Celgar's location also enables Mercer to access US markets, although weak US demand had made widespread distribution across America unviable.

Catalysts

'Mercer International vs Government of Canada' NAFTA Claim

Should Mercer win their aforementioned claim against the Government of Canada, they will receive an amount up to $250M and possibly a resolution to the disagreement in BC for the Celgar mill. These rewards would not only increase Mercer International's cash on hand, but also increase the profitability of the Celgar mill. Currently, the Celgar mill generates ~$10M in annual energy revenues. An additional $19M in annual energy revenues will significantly increase Celgar's profitability, and could be a major driver for future earnings. Mercer International's case is strong, and we believe they are likely to enjoy favourable results from the arbitration panel.

Management Team

In July 2015, Mercer International underwent management changes, with Jimmy Lee becoming the Executive Chairman of the Board and David Gandossi becoming President and CEO. This transition came jointly with Mercer International's refinancing and capital restructuring, along with the full acquisition of the Stendal mill.

David Gandossi, President & CEO

David Gandossi became Mercer International's CEO in July 2015 after serving as the company's CFO since 2003. Mr. Gandossi was involved in the Pulp and Paper Advisory Committee to the BC Competition Council and has chaired the BC Pulp and Paper Task Force since 2007, a joint program between labour forces and government aiming to improve the competitiveness of the BC pulp and paper industry. To supplement his involvement in these programs, Gandossi was also a member of BC's Working Roundtable on Forestry. These roles have provided years of exposure to the pulp and lumber industry as well as Mercer International's own operations.

Jimmy Lee, Executive Chairman of the Board

Jimmy Lee began serving as Mercer International's Executive Chairman of the Board in July 2015, following his twenty-three year service as President and CEO, since 1992. Mr. Lee led Mercer International as the company acquired the Rosenthal mill, constructed the Stendal mill and subsequently acquired the Celgar mill.

Risks

Foreign Exchange Risk

Mercer International operates in the American Dollar, and global trade exposes the company to foreign exchange risks. Mercer's operating costs are in Euros for Rosenthal and Stendal, while Celgar's operating costs are recorded in Canadian dollars and NBSK itself is quoted in US dollars. As a result, when each mill's costs are translated to US dollars, fluctuations will occur due to the value of the US dollar relative to that of the Euro and Canadian dollar. According to Mercer International's 2014 annual report, each $0.01 change in the value of the US dollar relative to the value of the Euro and Canadian dollar results in operating cost changes of $8M. Although the recent strengthening of the US dollar has benefited Mercer International, appreciation in the Euro or Canadian dollar could be materially disadvantageous to Mercer's margins and operations in the future.

Substitution Risk

Although NBSK is an essential input for tissue and specialty papers, hardwood pulp may be used in substitution for NBSK pulp in the production of printing and writing paper. Approximately 30% of Mercer International's sales are made to printing paper producers, and a price decrease in hardwood pulp or a price increase in NBSK could cause producers to switch to hardwood pulp. In addition, increasing global digitization has reduced demand for printing paper, and therefore lowering Mercer International's sales to printing paper producers.

Supply and Demand Risk

Price of NBSK is affected by global inventory for bleached softwood kraft (BSK). Surplus in supply of BSK or a decrease in demand can send NBSK prices downwards. In response, Mercer International has invested heavily in their biochemical and bioenergy production facilities to further diversify their business line, providing a defense against NBSK price volatiltiy. However, a sharp drop in NBSK prices would still be damaging to Mercer's bottom line.

Management Risk

Mercer International recently underwent management changes, appointing a new CEO and CFO. Although David Gandossi has significant experience in the pulp industry and within Mercer International itself, he has no prior experience as a CEO. Overseeing and executing strategic moves may pose a risk, considering Gandossi's minimal experience in such a role.

Distribution Costs Risk

With the recent instability in oil prices, distribution costs for pulp transportation have become increasingly volatile. This is especially relevant for Celgar's distribution to China, where the majority of pulp is delivered by rail to Vancouver, where it is then shipped via ocean carrier to Asia. In Germany, Mercer International distributes a majority of pulp by truck, as many of its European customers are within 500km of Rosenthal and Stendal. Increases in fuel have caused transportation costs to rise, forcing Mercer to target only the most freight-cost sensible customers overseas. Transportation costs account for 9% of Mercer International's operating costs, and this could rise should oil prices continue their current volatility.

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Regulatory Risk

Pulp mills are inherently susceptible to changes in environmental regulations, and mills must adhere to their country's environmental policies to avoid steep fines. Environmental regulations relevant to pulp mills typically include hazardous waste disposal, air pollution policies and waste water discharge. Should new regulations be passed, mills will be required to invest in mill upgrades to meet new regulations' standards, which could potentially cost millions.

Pulp mills are also susceptible to changes in workplace safety standards. Should new safety standards be passed, mills will be required to revamp safety procedures to avoid fines.

Shareholder Base & Liquidity

Shareholder Base

Mercer International's ownership is divided fairly equally between individual investors (26%), hedge funds (25%), insurance companies (23%) and institutional investment advisors (23%). Insider ownership is small, with only 4.74% of shares held by insiders, representing approximately $24M in insider holdings.

Liquidity

Mercer International's shares typically trade at higher volumes than similar companies, with trading volumes of 170,000; fairly high considering its market capitalization of 539M. Still, trading volumes at these levels cannot support large scale trades, which may cause liquidity risks for large investors.

Valuation

Discounted Cash Flow - Assumptions

A discounted cash flow (DCF) analysis was used to value Mercer International. A DCF analysis involves projecting free cash flows into perpetuity, and discounting them to the present, to obtain their present value. This is then used as the basis of the company's equity. We used a weighted average cost of capital of 9.25% to discount unlevered free cash flows, and assumed a long term perpetuity growth rate of 1% to calculate the firm's terminal value. Other assumptions were necessary to project free cash flows, and are discussed below:

1. Revenue

Due to Mercer International's steady production capacity, we felt it was safe to forecast pulp revenues as a function of mill capacity and global NBSK prices over the last five years. This resulted in annual revenue growth of 1%; A fair assumption considering Mercer's pulp production capacity has remained relatively static, and has no plans to acquire more mills.
Biochemical and bioenergy revenues have grown historically by about 5%, and given Mercer's investments in these divisions, we felt projecting 5% annual growth was viable.

2. Operating Costs

A core strategy for Mercer International is to increase production efficiency, and increase operating margins. We projected a decline of 3% in operating costs over the next ten years to reflect capital investments in each mill's production processes.

3. Taxes

Mercer International's complex tax assets were not accounted for in our DCF. Instead, we applied a flat 35% tax to Mercer's income.

4. Debt

The two outstanding senior notes on Mercer International's books contributed to annual interest expense, and are refinanced with similar notes upon maturity.

Comparable Company Analysis

The comparable valuation was conducted with a set of six companies:

1. Canfor Pulp Products
2. West Fraser Timber
3. Resolute Forest Products
4. Domtar Corp
5. Stora Enso
6. Fortress Paper

These companies represent a majority of the world's leading NBSK producers, and although their market capitalization may differ from Mercer International's, there is still value in comparing Mercer to these company's valuation multiples.

EV/EBITDA proved to be the most consistent multiple across the firms, implying a share price range of $9-$12. Despite the EV/Sales multiple implying a low price range of $4-$5, both P/E and EV/EBIT multiples showed upside for Mercer International.

Implied Target Price

A higher emphasis was placed on the DCF valuation, as the DCF implied share price reflects more firm-specific data than the comparable valuation. We applied a 70% weight to the DCF result, and a 30% weight to the result of the comparable valuation, resulting in a target price of $13.75.

Recommendation

We have placed Mercer International as a Buy, with upside of close to 70% over current prices on a one year horizon. Mercer has continued to use its capital investments wisely, not only increasing operational efficiency, but also hedging against possible NBSK price declines through the construction of bioenergy and biochemical facilities.

Should Mercer International continue to operate as it has historically, investors can expect a well operated company with improving margins, a dominant market position, growing dividends, and substantial growth opportunities for years to come.

Appendix 1: Discounted Cash Flow Model

BALANCE SHEET — Mercer International

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Cash & Cash Equivilants	147728	53172	137,288	233917	307925	385395	463554	547599	635307	728398	827638	930719	1034642
Other Current Operating Assets	324045	324663	326238	346077	350758	355547	360448	365465	370602	375864	381257	386785	392453
Net Property, Plant & Equipment	1038631	883150	742,930	753635	764426	775320	786331	797476	808769	820225	831859	843685	855717
Other Non-Current Assets	38155	65822	31603	59668	60476	61301	62146	63011	63897	64804	65734	66687	67664
Total Assets	**1548559**	**1326807**	**1238059**	**1393297**	**1483585**	**1577563**	**1672480**	**1773550**	**1878575**	**1989292**	**2106488**	**2227875**	**2350476**
Revolving Credit Facilities	0	0	0	0	0	0	0	0	0	0	0	0	0
Short-Term Portion of Debt	60355	12101	0	46906	46906	46906	46906	46906	46906	46906	46906	46906	46906
Other Current Operating Liabilities	119904	103402	127103	121962	121919	123583	125287	125266	127027	128831	128839	130707	132622
Long-term Debt	919017	675412	670092	670092	670092	670092	670092	670092	670092	670092	670092	670092	670092
Other Non-Current Liabilities	100966	97012	50565	82259	82229	83352	84501	84487	85675	86891	86896	88156	89448
Total Liabilities	**1200242**	**887927**	**847760**	**921219**	**921147**	**923934**	**926786**	**926752**	**929700**	**932720**	**932733**	**935861**	**939069**
Share Capital	328549	386338	388897	388897	388897	388897	388897	388897	388897	388897	388897	388897	388897
Additional Paid-In Capital	-11756	4769	4697	4697	4697	4697	4697	4697	4697	4697	4697	4697	4697
Accumulated other comprehensive income	31470	-52441	-153,102	-153,102	-153,102	-153,102	-153,102	-153,102	-153,102	-153,102	-153,102	-153,102	-153,102
Noncontrolling Interest	-10761	0	0	0	0	0	0	0	0	0	0	0	0
Retained Earnings	10815	100214	149,807	231586	321946	413137	505202	606307	708383	816080	933262	1051522	1170915
Total Shareholder Equity	**348317**	**438880**	**390299**	**472078**	**562438**	**653629**	**745694**	**846799**	**948875**	**1056572**	**1173754**	**1292014**	**1411407**

Appendix 2: Discounted Cash Flow Model

INCOME STATEMENT — Mercer International

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Revenue	1088385	1175112	1078001	1193368	1209511	1226026	1242925	1260224	1277938	1296084	1314679	1333740	1353286
Cost of Goods Sold	920832	887712	785859	871159	870848	882738	894906	894759	907336	920220	920275	933618	947300
Gross Profit	**167553**	**287400**	**292142**	**322209**	**338663**	**343287**	**348019**	**365465**	**370602**	**375864**	**394404**	**400122**	**405986**
Sale of Goods and Administration	51169	47927	48804	59668	60476	61301	62146	63011	63897	64804	65734	66687	67664
Other Operating Costs	6,415	0	0	0	0	0	0	0	0	0	0	0	0
EBITDA	**109,969**	**239,473**	**243338**	**262541**	**278188**	**281986**	**285873**	**302454**	**306705**	**311060**	**328670**	**333435**	**338322**
Depreciation, Depletion and Amortization	78309	77675	69478	66864	67827	68798	69779	70770	71773	72789	73820	74867	75932
EBIT	**31660**	**161798**	**173860**	**195677**	**210360**	**213188**	**216094**	**231684**	**234932**	**238271**	**254849**	**258568**	**262390**
Interest Expense (Income)	69156	67516	56080	58453	59933	61483	63046	64727	66481	61173	63158	65219	67298
Other Income	20,924	9,910	-63										
Pre-Tax Earnings	**-16,572**	**104,192**	**117780**	**137224**	**150427**	**151705**	**153048**	**166957**	**168451**	**177098**	**191692**	**193348**	**195092**
Tax	-9,196	16,774	-27,788	48028	52649	53097	53567	58435	58958	61984	67092	67672	68282
Net Income	**-25,768**	**120,966**	**145568**	**89196**	**97778**	**98608**	**99481**	**108522**	**109493**	**115114**	**124600**	**125676**	**126810**
Less: Net income attributable to noncontrolling interest	-607	-7,812	0	0	0	0	0	0	0	0	0	0	0
Net Income attributable to common shareholders	**-26,375**	**113,154**	**145,568**	**89,196**	**97,778**	**98,608**	**99,481**	**108,522**	**109,493**	**115,114**	**124,600**	**125,676**	**126,810**

Appendix 3: Discounted Cash Flow Model

CASH FLOW STATEMENT — Mercer International

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Net Income	-25768	120966	145568	89196	97778	98608	99481	108522	109493	115114	124600	125676	126810
Adjustments to reconcile Net Income to cash flows from operating activities	-2621	-28911	-1392										
Depreciation, Depletion and Amortization	78,645	78,012	69933	66864	67827	68798	69779	70770	71773	72789	73820	74867	75932
Changes in Current Operating Assets	-570	-18668	-26361	19839	4682	4789	4901	5017	5137	5262	5392	5528	5668
Changes in Current Operating Liabilities	-13361	-6811	17446	-5141	-43	1665	1703	-21	1761	1804	8	1868	1916
Change in Net Working Capital	-13931	-25479	43807	-24980	-4725	-3124	-3197	-5037	-3376	-3459	-5385	-3660	-3753
Cash from Operations	**36,325**	**144,588**	**257,916**	**131080**	**160880**	**164282**	**166063**	**174255**	**177890**	**184444**	**193035**	**196884**	**198989**
Capital Expenditures	-45,707	-39,388	-44742	-77569	-78618	-79692	-80790	-81915	-83066	-84245	-85454	-86693	-87964
Dispositions	0	0	0	0	0	0	0	0	0	0	0	0	0
Other Investing Activities	739	-9717	72	3628	-836	297	304	-879	302	309	-925	307	315
Cash from Investing	**-44968**	**-49105**	**-44670**	**-73941**	**-79455**	**-79395**	**-80486**	**-82793**	**-82764**	**-83936**	**-86379**	**-86386**	**-87649**
Revolving Credit Facilities				0	0	0	0	0	0	0	0	0	0
Dividends	0	0	0	-7417	-7417	-7417	-7417	-7417	-7417	-7417	-7417	-7417	-7417
Change in Debt	5,968	-236,310	-208905	46906	0	0	0	0	0	0	0	0	0
Change in Equity	9,265	60,558	773	0	0	0	0	0	0	0	0	0	0
Cash from Financing (Pre-Revolver)	**15233**	**-175752**	**-208132**	**39489**	**-7417**	**-7417**	**-7417**	**-7417**	**-7417**	**-7417**	**-7417**	**-7417**	**-7417**
Beginning Cash Balance				137288	233917	307925	385395	463554	547599	635307	728398	827638	930719
Effect of exchange rate changes on cash													
Changes in Cash (Pre-Revolver)				96,629	74,008	77,470	78,159	84,044	87,709	93,091	99,240	103,081	103,923
Ending Cash Balance (Pre-Revolver)				233917	307925	385395	463554	547599	635307	728398	827638	930719	1034642
Revolver Draw				0	0	0	0	0	0	0	0	0	0
Revolver Paydown				0	0	0	0	0	0	0	0	0	0
Ending Cash Balance			137288	233917	307925	385395	463554	547599	635307	728398	827638	930719	1034642

Appendix 4: Discounted Cash Flow Model

DISCOUNTED CASH FLOW ANALYSIS — Mercer International

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Current Debt to Total Capitalization			54%										
Current Tax Rate			35%										
Current Weighted Average Debt Yield-to-Maturity			7%										
Current LTM Equity Market Return			10%										
Current Risk Free Rate			3%										
Current LTM Equity Beta			1.64x										
Current Weighted Average Cost of Capital (WACC)			**9.25%**										
Long-term Perpetuity Growth Rate			1.00%										
EBIT				195677	210360	213188	216094	231684	234932	238271	254849	258568	262390
Tax Rate				*35%*	*35%*	*35%*	*35%*	*35%*	*35%*	*35%*	*35%*	*35%*	*35%*
Depreciation, Depletion and Amortization				66864	67827	68798	69779	70770	71773	72789	73820	74867	75932
Capital Expenditure				-77569	-78618	-79692	-80790	-81915	-83066	-84245	-85454	-86693	-87964
Change in Net Working Capital				-24980	-4725	-3124	-3197	-5037	-3376	-3459	-5385	-3660	-3753
Unlevered Free Cash Flow				**91505**	**121218**	**124554**	**126252**	**134413**	**138037**	**139961**	**148634**	**152583**	**154769**
Discounted Unlevered Free Cash Flow				83756	101556	95514	88617	86355	81173	75335	73227	68807	63882

Present Value of Projected Cash Flows	$ 818,223
Present Value of Perpetuity Cash Flows	$ 774,117
Total Enterprise Value	**$ 1,592,340**
Total Debt	$ 670,092
Cash	$ 137,288
Total Equity Value	**$ 1,059,536**
Shares Outstanding (thousands)	64,500
Price/Share	**$ 16.43**

		Discount Rate (WACC)							
	$ 16.43	7.00%	7.50%	8.00%	8.50%	9.00%	9.50%	10.00%	10.50%
Long-term Growth Rate	0.00%	$23.31	$21.07	$19.10	$17.37	$15.84	$14.47	$13.24	$12.13
	0.50%	$24.65	$22.17	$20.03	$18.15	$16.50	$15.04	$13.73	$12.55
	1.00%	$26.22	$23.45	$21.09	$19.04	$17.25	$15.67	$14.27	$13.02
	1.50%	$28.07	$24.95	$22.31	$20.05	$18.09	$16.38	$14.87	$13.53
	2.00%	$30.28	$26.71	$23.73	$21.21	$19.06	$17.19	$15.55	$14.11
	2.50%	$32.99	$28.83	$25.42	$22.58	$20.17	$18.11	$16.32	$14.76
	3.00%	$36.38	$31.41	$27.44	$24.18	$21.47	$19.17	$17.20	$15.50
	3.50%	$40.74	$34.65	$29.91	$26.11	$23.01	$20.42	$18.22	$16.34

Appendix 5: Comparable Company Analysis

TRADING COMPARABLES ANALYSIS — Mercer International

Company	Price	Mkt-Cap	Cash	T. Debt	EV	LTM Sales	LTM EBITDA	LTM EBIT	LTM Net Income	EV/Sales	EV/EBITDA	EV/EBIT	P/E
Canfor Pulp Products Inc	11.52	802.30	16.60	50.00	835.70	1107.90	195.40	132.60	97.60	0.75	4.28	6.30	8.22
West Fraser Timber Inc	44.78	3692.30	21.00	466.00	4137.30	4051.00	498.00	314.00	162.00	1.02	8.31	13.18	22.79
Resolute Forest Products	7.64	682.30	235.00	597.00	1044.30	3806.00	331.00	-86.00	-152.00	0.27	3.15	-12.14	-4.49
Domtar Corp	33.44	2101.70	128.00	1288.00	3261.70	5329.00	717.00	280.00	156.00	0.61	4.55	11.65	13.47
Stora Enso	8.39	6201.00	1010.00	4191.00	9382.00	10105.00	1465.00	516.00	258.00	0.93	6.40	18.18	24.03
Fortress Paper Ltd	4.74	69.80	53.20	239.50	256.10	307.50	1.60	-27.60	-43.90	0.83	n.m.	-9.28	-1.59
Mercer International	**8.37**	**539.90**	**137.30**	**670.10**	**1072.70**	**1078.00**	**243.80**	**173.90**	**57.00**	**1.00x**	**4.40x**	**6.17x**	**9.47x**
High										1.0x	8.3x	18.2x	24.0x
Average										**0.7x**	**5.3x**	**4.6x**	**10.4x**
Median										**0.8x**	**4.5x**	**9.0x**	**10.8x**
Low										0.3x	3.2x	-12.1x	-4.5x

	EV/Sales	EV/EBITDA	EV/EBIT	P/E
Implied Market Capitalization - High	$568	$1,493	$2,629	$1,370
Implied Market Capitalization - Average	**$262**	**$769**	**$275**	**$593**
Implied Market Capitalization - Median	**$323**	**$576**	**$1,028**	**$618**
Implied Market Capitalization - Low	-$237	$236	-$2,644	-$256

	EV/Sales	EV/EBITDA	EV/EBIT	P/E
Implied Price Per Share - High	$9	$23	$41	$21
Implied Price Per Share - Average	**$4**	**$12**	**$4**	**$9**
Implied Price Per Share - Median	**$5**	**$9**	**$16**	**$10**
Implied Price Per Share - Low	-$4	$4	-$41	-$4

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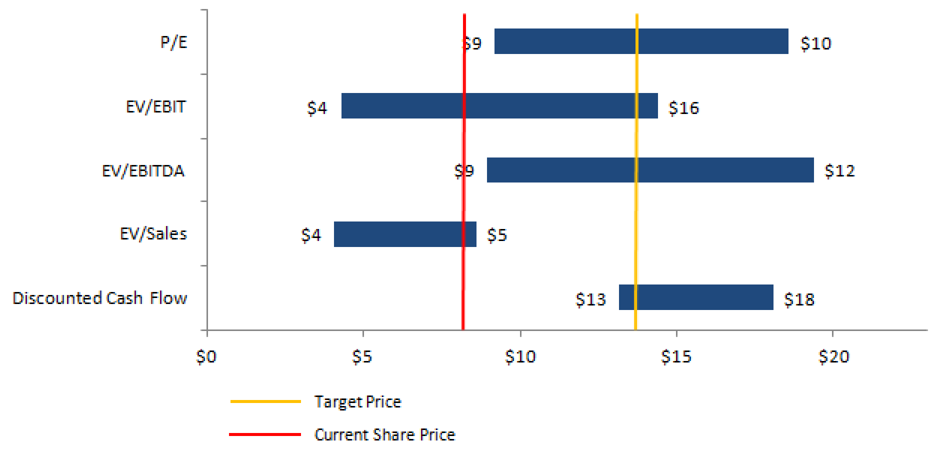
Appendix 5: Valuation Summary

VALUATION SUMMARY

Mercer International

Market Capitalization Valuation	**Low**	**Average**	**High**
Discounted Cash Flow	$13	$16	$18
EV/Sales	$4		$5
EV/EBITDA	$9		$12
EV/EBIT	$4		$16
P/E	$9		$10
Discounted Cash Flow	$13	$5	$18
EV/Sales	$4	$5	$5
EV/EBITDA	$9	$10	$12
EV/EBIT	$4	$10	$16
P/E	$9	$9	$10



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