

MERCER INTERNATIONAL INC.

Form 10-K

February 10, 2017

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

**[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2016**

**OR**

**[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File No.: 000-51826**

**MERCER INTERNATIONAL INC.**

*(Exact name of Registrant as specified in its charter)*

**Washington**

**47-0956945**

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(State or other jurisdiction

(IRS Employer Identification No.)

of incorporation or organization)

**Suite 1120, 700 West Pender Street,**

**Vancouver, British Columbia, Canada**

**V6C 1G8**

(Address of Principal Executive Office)

(Zip Code)

Registrant's telephone number including area code: **(604) 684-1099**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
<b>Common Stock, par value \$1.00 per share</b>	<b>NASDAQ Global Select Market</b>

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

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

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

Indicate by check mark whether Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes  No

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller

reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act).  Yes  No

The aggregate market value of the Registrant's voting and non-voting common equity held by non-affiliates of the Registrant as of June 30, 2016, the last business day of the Registrant's most recently completed second fiscal quarter, based on the closing price of the voting stock on the NASDAQ Global Select Market on such date, was approximately \$516.3 million. As of February 9, 2017, the Registrant had 64,694,138 shares of common stock, \$1.00 par value per share, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Certain information that will be contained in the definitive proxy statement for the Registrant's annual meeting to be held in 2017 is incorporated by reference into Part III of this Form 10-K.

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This annual report on Form 10-K includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words such as believes, expects, anticipates, estimates, intends, seeks or words of similar meaning, or future or conditional verbs, such as will, should, could, may, aims, projects. A forward-looking statement is neither a prediction nor a guarantee of future events or circumstances, and those future events or circumstances may not occur. You should not place undue reliance on forward-looking statements, which speak only as of the date of this annual report on Form 10-K. These forward-looking statements are all based on currently available operating, financial and competitive information and are subject to various risks and uncertainties. Our actual future results and trends may differ materially depending on a variety of factors, including, but not limited to, the risks and uncertainties discussed under Item 1. Business, Item 1A. Risk Factors and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. Given these risks and uncertainties, you should not rely on forward-looking statements as a prediction of actual results. Any or all of the forward-looking statements contained in this annual report on Form 10-K and any other public statement made by us, including by our management, may turn out to be incorrect. We are including this cautionary note to make applicable and take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 for forward-looking statements. We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**INDUSTRY AND MARKET DATA**

In this document, 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 information 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, we have not independently verified and cannot guarantee the accuracy or completeness of that information, and readers should use caution in placing reliance on such information.

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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 dollars to euros and Canadian 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:

	<b>Year Ended December 31,</b>				
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
			(\$/ )		
End of period	1.0552	1.0859	1.2101	1.3779	1.3186
High for period	1.0375	1.0524	1.2101	1.2774	1.2062
Low for period	1.1516	1.2015	1.3927	1.3816	1.3463
Average for period	1.1072	1.1096	1.3297	1.3281	1.2859
			(\$/C\$)		
End of period	0.7448	0.7226	0.8620	0.9401	1.0042
High for period	0.6853	0.7148	0.8588	0.9348	0.9600
Low for period	0.7972	0.8529	0.9423	1.0164	1.0299
Average for period	0.7558	0.7830	0.9060	0.9712	1.0007

On February 6, 2017, the most recent weekly publication of the daily Noon Buying Rate before the filing of this annual report on Form 10-K reported that the Noon Buying Rate as of February 3, 2017 for the conversion of dollars to euros and Canadian dollars was \$1.0792 per euro and \$0.7691 per Canadian dollar.



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**PART I**

**ITEM 1. BUSINESS**

In this document, please note the following:

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

references to *net income (loss)* mean net income (loss) attributable to common shareholders;

references to *NBSK* mean northern bleached softwood kraft;

references to *ADMTs* mean air-dried metric tonnes;

references to *MW* mean megawatts and *MWh* mean megawatt hours; and

all references to *\$* or *dollars* shall mean U.S. dollars, which is our reporting currency, unless otherwise stated; *€* refers to euros; and *C\$* refers to Canadian dollars.

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

**Mercer**

***General***

Mercer Inc. is a corporation organized under the laws of the State of Washington. Its common stock is quoted and listed for trading on the NASDAQ Global Select Market (MERC) and the Toronto Stock Exchange (MERC.U).

We are one of the world's largest producers of market NBSK pulp, which is pulp that is sold on the open market. Our size provides us increased presence, better industry information in our markets and close customer relationships with many large pulp consumers. We operate two modern and highly efficient mills in Eastern Germany and one mill in Western Canada and have our headquarters in Vancouver, Canada. We are the sole NBSK pulp producer, and the only significant market pulp producer in Germany, which is the largest pulp import market in Europe. We are able to supply the growing pulp demand in China both through our Canadian mill's ready access to the Port of Vancouver and through our Stendal mill's existing logistics arrangements. In addition, as a result of the significant investments we have made in co-generation equipment, all of our mills generate and sell a significant amount of surplus green energy to regional utilities. We also produce and sell tall oil, a by-product of our production process, which is used as both a chemical additive and as a green energy source.

We currently employ approximately 1,486 people. Our three NBSK pulp mills have consolidated annual production capacity of approximately 1.5 million ADMTs of NBSK pulp and are capable of generating 305 MW of electricity. Key operating details for each of our mills are as follows:

***Rosenthal mill.*** Our Rosenthal mill is a modern, efficient ISO 9001, 14001 and 50001 certified NBSK pulp mill that has an annual production capacity of approximately 360,000 ADMTs and 57 MW of electrical generation. The Rosenthal mill is located in the town of Blankenstein, Germany, approximately 300 kilometers south of Berlin.

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**Stendal mill.** Our Stendal mill is a state-of-the-art, single-line, ISO 9001, 14001 and 50001 certified NBSK pulp mill that has an annual production capacity of approximately 660,000 ADMTs and 148 MW of electrical generation. The Stendal mill is one of the largest NBSK mills in Europe. The Stendal mill is located near the town of Stendal, Germany, approximately 130 kilometers west of Berlin.

**Celgar mill.** Our Celgar mill is a modern, efficient ISO 9001 and 14001 certified NBSK pulp mill with an annual production capacity of approximately 520,000 ADMTs and 100 MW of electrical generation. The Celgar mill is located near the city of Castlegar, British Columbia, Canada, approximately 600 kilometers east of Vancouver.

Our mills are some of the most modern and newest NBSK pulp mills in Europe and North America. We believe the relative age, production capacity and electrical generation capacity of our mills provide us with certain manufacturing cost and other advantages over many of our competitors. We believe our competitors' older mills do not have the equipment or capacity to produce or sell surplus power or chemicals in a meaningful amount. In addition, since our mills are relatively new, they benefit from lower maintenance capital requirements and higher efficiency relative to many of our competitors' mills.

The following table sets out our pulp production and pulp revenues for the periods indicated:

	Year Ended December 31,		
	2016	2015	2014
Pulp production ( '000 ADMTs)	1,428.4	1,458.0	1,485.0
Pulp sales ( '000 ADMTs)	1,428.7	1,463.1	1,486.4
Pulp revenues (in thousands)	\$ 847,328	\$ 946,237	\$ 1,073,632

Our modern mills generate electricity, which is surplus to their operating requirements, providing our mills with a stable revenue source unrelated to pulp prices. Additionally, our German mills generate tall oil from black liquor, which is sold to third parties for use in numerous applications including bio-fuels. Since our energy and chemical production are by-products of our pulp production process, there are minimal incremental costs and our surplus energy and chemical sales are highly profitable. All of our mills generate and sell surplus energy to regional utilities. Our German mills benefit from special tariffs under Germany's *Renewable Energy Sources Act*, referred to as the *Renewable Energy Act*, which provides for premium pricing on green energy. Our Celgar mill is party to a fixed electricity purchase agreement with the regional public utility provider for the sale of surplus power through 2020.

The following table sets out the amount of surplus energy produced and sold and revenues from the sale of surplus energy and chemicals for the periods indicated:

	Year Ended December 31,					
	2016		2015		2014	
	(MWh)	(\$ (thousands))	(MWh)	(\$ (thousands))	(MWh)	(\$ (thousands))
Surplus electricity	785,845	71,539	814,966	74,736	807,758	88,758
Chemicals		12,756		12,231		12,722

Total	84,295	86,967	101,480
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Our strategic mill locations position us well to serve customers in Europe, Asia, and North America. We primarily work directly with customers to capitalize on our geographic diversity, coordinate sales and enhance customer relationships. We believe our ability to deliver high quality pulp on a timely basis and our customer service make us a preferred supplier for many customers.

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Fiber is the largest production cost in manufacturing NBSK pulp. Although fiber is cyclical in both price and supply, there is a significant amount of high-quality fiber within a close radius of each of our mills. This fiber supply, combined with our purchasing power and our ability to switch between whole logs chipped at our mills and sawmill residual chips, enables us to enter into contracts and arrangements which have generally provided us with sufficient fiber supply.

### ***Corporate Structure, History and Development of Business***

The following simplified chart sets out our principal operating subsidiaries, their jurisdictions of organization, their principal activities and their annual pulp production and electrical generation capacity:

We acquired our Rosenthal mill in 1994. In 1999, we completed a major capital project to convert it to the production of kraft pulp, increase production and improve efficiencies at a cost of approximately \$385.7 million, of which approximately \$100.8 million was financed through government grants. Subsequent capital investments and efficiency improvements have reduced emissions and energy costs, increased the mill's annual production capacity and enabled the production of tall oil.

In September 2004, we completed construction of the Stendal mill at a cost of approximately \$1.1 billion, which was financed through a combination of government grants of approximately \$332.0 million, low-cost, long-term project debt, which was largely severally guaranteed by governments in Germany, and equity. Subsequent capital investments and efficiency improvements have increased the mill's annual production capacity and its generation of green energy. We initially had a 63.6% interest in Stendal which increased over time through acquisitions and/or further investments until September 2014, when we acquired all of the economic interest in Stendal.

In February 2005, we acquired the Celgar mill for \$210.0 million plus defined working capital. Since its acquisition, we have effected several capital projects and other initiatives at the Celgar mill to increase its annual production capacity and its generation of green energy.

### **Corporate Strategy**

Our corporate strategy is to expand 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 to generate a high return by improving efficiency, reducing

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costs and increasing production of pulp and energy and by-products such as chemicals. We are also leveraging our fiber and process expertise to develop innovative new products based on other derivatives of the kraft pulping process. We seek to acquire interests in companies and assets in the pulp industry and related wood and wood extractive businesses where we can leverage our experience and expertise in adding value through a focused management approach. Key elements of our strategy include:

***Focus on Premium Grade Market NBSK Pulp.*** We produce market NBSK pulp because it is a premium grade kraft pulp and generally obtains the highest price relative to other kraft pulps. Although demand is cyclical, between 2007 and 2016 overall worldwide demand for bleached softwood kraft market pulp grew at an average of approximately 1% per annum. We focus on customers that produce tissue, specialty papers and high-quality printing and writing paper grades. We believe the growth in demand from tissue and specialty paper customers, which utilize a significant proportion of NBSK pulp, has more than offset the secular decline in demand from printing and writing paper customers. This allows us to benefit from our long-term relationships with tissue and specialty paper manufacturers in Europe and participate in higher growth markets in emerging countries such as China where there has been strong growth in tissue demand.

***Increasing Stable Revenues from Renewable Energy and Chemical Sales and Leveraging our Fiber and Process Expertise to Expand Growth.*** We focus on enhancing our generation and sales of surplus renewable energy and chemicals and, because there are minimal associated incremental costs, such sales are highly profitable. These sales provide us with a stable income source unrelated to cyclical changes in pulp prices. Additionally, we seek to capitalize on our fiber and process expertise to expand our commercialization and sales of new products and into new growth areas.

***Targeted Capital Expenditures to Enhance Production Capacity and Efficiency.*** We operate three large modern pulp mills which provide us with a platform to be an efficient and competitive producer of high-quality NBSK pulp without the need for significant sustaining capital. We seek to make targeted capital expenditures to increase production and operational efficiency, reduce costs and increase electricity and chemical sales. Over the last five years, we have invested approximately \$159.1 million (including \$24.2 million in associated government grants) in growth capital expenditures for capacity expansions, operational efficiencies and renewable energy and chemical production.

***Achieving Operational Excellence.*** Operating our mills reliably and at a competitive cost is important for our financial performance. In addition to capital expenditures, we continuously strive to develop maintenance systems and procedures that will improve the throughput of our products by increasing the reliability of our manufacturing processes. We also seek to reduce operating costs by better managing certain operating activities such as fiber procurement, sales, marketing and logistics activities. We believe that our continued focus on operational excellence should allow us to achieve improved profitability and cash flows.

***Strategic Opportunities.*** We believe there will be continuing change and consolidation in pulp and related wood harvesting, processing and extractive businesses as industry participants continually seek to lower costs, refocus their product lines and react to ever changing global market conditions. We take an opportunistic approach to potential investments or acquisitions that can grow our business and expand our earnings.

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### **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, a type of chemical pulp, is produced through a sulphate chemical process in which lignin, the component of wood which binds individual fibers, is dissolved in a chemical reaction. Chemically prepared pulp allows the wood's fiber to retain its length and flexibility, resulting in stronger paper products. Kraft pulp can be bleached to increase its brightness. Softwood 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 other paper-related products.

There are two main types of bleached kraft pulp, being softwood kraft made from coniferous trees and hardwood kraft made from deciduous trees. 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.

We produce and sell NBSK pulp, which is a bleached kraft pulp manufactured using northern softwood and 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 and does not possess the strength found in NBSK pulp. NBSK pulp is the sole pulp product of our mills.

Most paper users of market kraft pulp use a mix of softwood and hardwood grades to optimize production and product qualities. In 2016, market kraft pulp consumption was approximately 54% hardwood bleached kraft and 42% softwood bleached kraft, with the remainder comprised of unbleached pulp. Over the last several 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, based on fiber that has longer growth cycles. Hardwood kraft generally has a cost advantage over softwood kraft as a result of lower fiber costs, higher wood yields and, for newer hardwood mills, economies of scale. As a result of this growth in supply and lower costs, kraft pulp customers have substituted some of the pulp content in their products to hardwood pulp.

Counteracting customers' ability to substitute lower priced hardwood pulp for NBSK pulp is the requirement for strength and formation characteristics in finished goods. Paper and tissue makers focus on larger paper machines with higher speeds and lower basis weights for certain papers which require the strength characteristics of softwood pulp. Additionally, where paper products are lightweight or specialized, like direct mail, magazine paper or premium tissue, or where strength or absorbency are important, softwood kraft forms a significant proportion of the fiber used. As a result, we believe that the ability of kraft pulp users to further substitute hardwood for softwood pulp is limited by such requirements.

Kraft pulp can be made in different grades, with varying technical specifications, for different end uses. Softwood kraft pulp is valued for its reinforcing role in mechanical printing papers and is sought after by producers of paper for the publishing industry, primarily for magazines and advertising materials. Softwood kraft pulp is also an important ingredient for tissue manufacturing and tissue demand tends to increase with living standards in developing countries. NBSK pulp produced for reinforcement fibers is considered the highest grade of kraft pulp and generally obtains the highest price.



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***Markets***

We believe that over 130 million ADMTs of chemical pulp are converted annually into tissues, printing and writing papers, carton boards and other specialty grades of paper and paperboard around the world. We also believe that over one third of this pulp is sold on the open market as market pulp, while the remainder is produced for internal purposes by integrated paper and paperboard manufacturers.

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

Between 2007 and 2016, worldwide demand for chemical market pulp grew at an average rate of approximately 2% annually, with worldwide demand for bleached softwood kraft market pulp having grown at an average of approximately 1% per annum.

The following chart illustrates the global demand for chemical market pulp for the periods indicated:

**Estimated Global Chemical Market Pulp Demand**

Two key macro-economic trends in worldwide NBSK pulp demand over the last several years have been:

a significant increase in demand from emerging markets, and in particular China, which has more than offset a decline in demand in the mature markets of Europe, North America and Japan; and

a significant shift in demand by end use, as demand from tissue and specialty producers has increased markedly and offset the secular decline in demand for printing and writing paper resulting from the rapid growth in digital media.

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Since 2007, demand for chemical softwood market pulp has grown in the emerging markets of Asia, Eastern Europe and Latin America. China in particular has experienced substantial growth and its imports of chemical softwood market pulp grew by approximately 11% per annum between 2007 and 2016. We believe the emerging markets now account for approximately 54% of total world demand for bleached softwood kraft market pulp. China now accounts for approximately 31% of global bleached softwood kraft market pulp demand, compared to only 15% in 2007. Western Europe currently accounts for approximately 25% of global bleached softwood kraft market pulp demand, compared to approximately 35% in 2007. The demand in the mature markets of Europe, North America and Japan in 2016 declined by approximately 2.8 million ADMTs from 2007.

The following chart sets forth industry-wide bleached softwood kraft deliveries to China for the periods indicated:

**12 Month Rolling Bleached Softwood Kraft Pulp Deliveries to China**

Growth in NBSK pulp demand in China and other emerging markets has, to a large extent, been driven by increased demand from tissue and specialty paper producers, as a result of economic growth and rising income levels and living standards in such markets. These factors generally contribute to a greater demand for personal hygiene products in such regions. In China alone, tissue producers have publicly announced plans to increase their annual tissue capacity by approximately 0.6 million ADMTs during 2017. At this time there can be no assurance as to when and how much of such capacity expansion will be implemented.

This has also led to an overall shift in demand for NBSK pulp, as demand from tissue producers has increased, while demand from printing and writing end uses has decreased. Between 2003 and 2015, NBSK pulp demand for tissue production increased by approximately 206%, an approximate 10% compound annual growth rate. From 2003 to 2015, a period very affected by digital substitution of traditional paper grades, total NBSK demand grew by 15%.

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The following chart compares NBSK pulp demand by end use in each of 2003 and 2015 (the latest year for which figures are currently available):

**NBSK Pulp Demand by End Use**

We believe 2016 NBSK demand by end use was generally consistent with the trend in the chart above.

A measure of demand for kraft pulp is the ratio obtained by dividing the worldwide demand of kraft pulp by the worldwide capacity for the production of kraft pulp, or the demand/capacity ratio. An increase in this ratio generally occurs when there is an increase in global and regional levels of economic activity. An increase in this ratio also generally indicates greater demand as consumption increases, which often results in rising kraft pulp prices and a reduction of inventories by producers and buyers. 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 buyers to reduce their purchases and rely on existing pulp inventories. As a result, producers run at lower operating rates by taking downtime to limit the build-up of their own inventories. The demand/capacity ratio for bleached softwood kraft pulp was approximately 92%, 92% and 93% in 2016, 2015 and 2014, respectively.

Between 2012 and 2016, we believe approximately 0.8 million ADMTs of pulp capacity was idled or shut down through mill closures or curtailments. Further, in efforts to improve environmental and safety standards, China has publicly stated that it will be reducing existing pulp and paper capacity in the near term by closing old mills, targeting a removal of 3.4 million ADMTs by the end of 2015. At this time, there can be no certainty as to the actual amount and timing of any such closures.

Currently, there have been publicly announced significant increases to expand chemical pulp capacity worldwide. Producers have announced projects to increase hardwood kraft pulp capacity by an aggregate of about 3.2 million ADMTs in 2017 and 2018, primarily in South America and Asia. Further capacity increases of about 0.7 million ADMTs have been announced for 2019. This increase in bleached hardwood kraft pulp is largely targeted at the growing demand for pulp in developing markets, particularly in China, by producers of tissues, specialty papers and packaging. Although not a direct competitor to NBSK pulp, if such additional bleached hardwood kraft pulp supply is not absorbed by such demand growth, as a result of generally lower prices for bleached hardwood kraft pulp, this supply increase could

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put downward pressure on NBSK pulp prices. However, we believe customers' ability to further substitute lower priced bleached hardwood kraft pulp for NBSK pulp is limited by the strength characteristic of NBSK pulp which is required by large modern paper machines to run lower basis-weight paper products efficiently.

Producers have also publicly announced modernization and expansion projects for NBSK mills in Europe, including Russia, to be implemented in 2017 and 2018, ranging from small expansions of existing mills to potential greenfield mills. We estimate that if all of these projects were completed, they would increase NBSK pulp capacity by about 1.9 million ADMTs per annum. Further capacity increases of about 0.5 million ADMTs of NBSK pulp have been announced for 2019. We currently believe a number of such projects will be implemented while others are currently subject to various conditions including financing and further development. We believe that, because of fiber constraints, such a significant expansion of NBSK capacity in the region would likely require the closure of older mills. However, at this time, we cannot predict which of the publicly announced expansion projects will be completed or how much additional NBSK pulp production capacity may come online and when. As pulp prices are highly cyclical, there can be no assurance that NBSK pulp prices will not decline in the future as a result of increases to the supply of kraft pulp.

In addition, certain integrated pulp and paper producers have the ability to discontinue paper production by idling their paper machines and selling their NBSK pulp production on the market, if market conditions, prices and trends warrant such actions.

### ***NBSK Pulp Pricing***

Kraft pulp is a globally traded commodity and prices are highly cyclical and volatile. Kraft pulp prices are generally quoted in dollars. Pricing is primarily influenced by the balance between supply and demand, as affected by global macro-economic conditions, changes in consumption and capacity, the level of customer and producer inventories and fluctuations in exchange rates. Generally, we and other producers consider global NBSK pulp supply and demand to be evenly balanced when world inventory levels are at about 30 days' supply.

General macro-economic conditions are closely tied to overall global business activity, which helps determine pulp demand and, in turn, impacts pricing.

As the majority of market NBSK pulp is produced and sold by Canadian and Northern European producers, while the price of NBSK pulp is generally quoted in dollars, pricing is often affected by fluctuations in the currency exchange rates for the dollar versus the euro and the Canadian dollar. As NBSK pulp producers generally incur costs in their local currency, while pulp is quoted in dollars, a dollar strengthening generally benefits producers' businesses and operating margins. Conversely, a weakening of the dollar versus the local currency of producers generally adversely affects producers' businesses and operating margins.

As a corollary to changes in exchange rates between the dollar and the euro and Canadian dollar, a stronger dollar generally increases costs to customers of NBSK pulp producers and results in downward pressure on prices. Conversely, a weakening dollar generally supports higher pulp pricing. However, there is invariably a time lag between changes in currency exchange rates and pulp prices. This lag can vary and is not predictable with any certainty.

As Northern Europe has historically been the world's largest market and NBSK pulp is the premium grade, the European market NBSK price is generally used as a benchmark price by the industry. The average European list prices for NBSK pulp since 2007 have fluctuated between a low of approximately \$575 per ADMT in 2009 and a high of \$1,030 per ADMT in 2011.



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The following chart sets out the changes in list prices for NBSK pulp in Europe, as stated in dollars, Canadian dollars and euros for the periods indicated:

**NBSK Pulp Price History (European Delivery)**

In 2016 and 2015, demand was generally stable. However, the strength of the dollar resulted in lower pulp prices. In 2014, demand from both Europe and China was stable, while supply was slightly under-balanced throughout the year which kept prices relatively high.

The following table sets out list prices for NBSK pulp in the regions indicated at the dates indicated:

	<b>2016</b>	<b>December 31, 2015</b>	<b>2014</b>
	<b>(in \$/ADMT)</b>		
Europe	810	800	935
China	605	595	700
North America	990	940	1,020

A producer's net sales realizations are list prices, net of customer discounts, rebates and other selling concessions. Over the last three years, these have increased as producers compete for customers and sales. The nature of the pricing structure in Asia is different in that, while quoted list prices tend to be lower than Europe, customer discounts and rebates are much lower, resulting in net sales realizations that are generally similar to other markets.

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The following chart sets forth changes in FOEX PIX Pulp Index prices for NBSK pulp in Europe and global bleached softwood kraft inventory levels between 2003 and 2016:

**Pulp Price and Global Inventory History**

***Seasonality***

We are exposed to fluctuations in quarterly sales volumes and expenses due to seasonal factors. These factors are common in the NBSK pulp industry. We generally have weaker pulp demand in Europe during the summer holiday months and in China in the period relating to its lunar new year. We typically have a seasonal build-up in raw material inventories in the early winter months as our mills build up their fiber supply for the winter when there is reduced availability.

***Competition***

Pulp markets are large and highly competitive. Producers ranging from small independent manufacturers to large integrated companies produce pulp worldwide. Our pulp and customer services compete with similar products manufactured and distributed by others. While many factors influence our competitive position, particularly in weak economic times, a key factor is price. Other factors include service, quality and convenience of location. Some of our competitors are larger than we are in certain markets and have substantially greater financial resources. These resources may afford those competitors more purchasing power, increased financial flexibility, more capital resources for expansion and improvement and enable them to compete more effectively. Our key NBSK pulp competitors are principally located in Northern Europe and Canada and include Canfor Pulp, Stora Enso, Metsä Fibre, Ilim, Södra Cell and Asia Pulp and Paper.

**Table of Contents****Pulp Production**

Our pulp production capacity and actual production by mill for the periods indicated is set out below:

	Annual Production Capacity <sup>(1)</sup>	Year Ended December 31,		
		2016	2015 (ADMTs)	2014
<b><u>Pulp Production by Mill:</u></b>				
Rosenthal	360,000	353,486	353,099	360,463
Celgar	520,000	426,317	453,215	453,104
Stendal	660,000	648,581	651,659	671,444
Total pulp production	1,540,000	1,428,384	1,457,973	1,485,011

(1) Capacity is the rated capacity of the plants for the year ended December 31, 2016.

Softwood kraft pulp is valued for its reinforcing role in mechanical printing papers and is sought after by producers of paper for the publishing industry, primarily for magazines and advertising materials. Softwood kraft pulp is also an important ingredient for tissue manufacturing, and tissue demand tends to increase with living standards in developing countries. NBSK pulp produced for reinforcement fibers is considered the highest grade of kraft pulp and generally obtains the highest price.

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

The NBSK pulp produced at the Stendal mill is of a slightly different grade than the pulp produced at the Rosenthal mill as the mix of softwood fiber used is slightly different. This results in a complementary product more suitable for different end uses. The Stendal mill is capable of producing both totally chlorine free and elemental chlorine free pulp.

The Celgar mill produces high-quality NBSK pulp that is made from a unique blend of slow growing/long-fiber Western Canadian tree species. It is used in the manufacture of high-quality paper and tissue products. We believe the Celgar mill's pulp is known for its excellent product characteristics, including tensile strength, wet strength and brightness. The Celgar mill is a long-established supplier to paper and tissue producers in Asia.

**Generation and Sales of Green Energy and Chemicals at our Mills**



Our pulp mills are large scale bio-refineries that, in addition to pulp, also produce surplus carbon neutral or green energy. As part of the pulp production process our mills generate green energy using carbon-neutral bio-fuels such as black liquor and wood waste. Through the incineration of bio-fuels in the

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recovery and power boilers, our mills produce sufficient steam to cover all of our steam requirements and allow us to produce surplus electricity which we sell to third party utilities. As a result, we have benefited from green energy legislation, incentives and commercialization that have developed over the last decade in Europe and Canada. In addition, in recent years we have applied considerable resources to increasing our capacity to produce and sell chemicals, primarily tall oil for use in numerous applications including bio-fuels.

Our surplus energy and chemical sales provide our mills with a stable revenue source unrelated to pulp prices. Since our energy and chemical production are by-products of our pulp production process, there are minimal incremental costs and our surplus energy and chemical sales are highly profitable. We believe that this revenue source gives our mills a competitive advantage over other older mills which do not have the equipment or capacity to produce and/or sell surplus power and/or chemicals in a meaningful amount.

The following table sets out our electricity generation and surplus electricity sales for the five years ended December 31, 2016:

**Electricity Generation and Exports**

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The following chart sets forth our consolidated revenues from electricity and chemical sales for the five years ended December 31, 2016:

**Energy and Chemical Revenue**

***German Mills***

Our German mills participate in a program established pursuant to the Renewable Energy Act, which requires that public electric utilities give priority to electricity produced from renewable energy sources by independent power producers and pay a fixed tariff for such electricity for a period of 20 years. Such tariff expires December 31, 2019 for our Rosenthal mill and December 31, 2024 for our Stendal mill. Recent amendments to the Renewable Energy Act will extend their initial terms for a further 10-year period, based upon the price received in the last year prior to renewal regressing at a rate of 8% per annum. Such amendments are subject to compliance with EU state aid rules. While we expect them to be effective, we can provide no assurance of the same.

Since 2005, our German mills have received emission allowances under the European Union Carbon Emissions Trading Scheme, referred to as the EU ETS. However, our eligibility for special tariffs under the Renewable Energy Act has reduced the amount of emissions allowances granted to our German mills under the EU ETS.

In 2016, our Rosenthal and Stendal mills sold approximately 169,249 MWh and 479,310 MWh of electricity, respectively, for proceeds of \$17.1 million and \$45.0 million, respectively.

In 2016, our Rosenthal and Stendal mills generated \$1.5 million and \$10.6 million, respectively, from the sale of tall oil, a by-product of our production process. In 2014, our Rosenthal mill completed a capital project which allowed it to process and sell tall oil.

***Celgar Mill***

The Celgar mill has an electricity sales agreement with British Columbia Hydro and Power Authority, referred to as B.C. Hydro, for the sale of power generated, pursuant to which the mill agreed to supply a minimum of approximately 238,000 MWh of surplus electrical energy annually to the utility over a ten-year term. The agreement expires in 2020.

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In 2016, our Celgar mill sold approximately 137,286 MWh of renewable electricity for proceeds of approximately \$9.4 million.

In 2012, we initiated a claim against the Government of Canada under the North American Free Trade Agreement, referred to as NAFTA, relating to our investment in Celgar and unfair and discriminatory treatment regarding its ability to purchase and sell energy. See Item 3. Legal Proceedings.

**Cash Production Costs**

Consolidated cash production costs per ADMT for our pulp mills are set out in the following table for the periods indicated:

Cash Production Costs	Year Ended December 31,					
	2016		2015		2014	
	(per ADMT)	(%)	(per ADMT)	(%)	(per ADMT)	(%)
Fiber	\$ 264	60	\$ 286	62	\$ 332	62
Labor	52	12	51	11	58	11
Chemicals	51	12	51	11	59	11
Energy	20	5	18	4	29	5
Other	54	11	59	12	57	11
Total cash production costs <sup>(1)</sup>	\$ 441	100	\$ 465	100	\$ 535	100

(1) Cash production costs per ADMT excludes depreciation and amortization.

**Production Costs**

Our major costs of production are fiber, labor, chemicals and energy. Fiber, comprised of wood chips and pulp logs, is our most significant operating expense, representing about 60% of our cash production costs in 2016. Given the significance of fiber to our total operating expenses and our limited ability to control its costs, compared with our other operating costs, volatility in fiber costs can materially affect our margins and results of operations.

**Fiber**

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

Generally, the cost of wood chips and pulp logs is primarily affected by the supply and demand for lumber. Additionally, regional factors such as harvesting levels and weather conditions can also have a material effect on the supply, demand and price for fiber.

In Germany, the price and supply of wood chips has been affected by increasing demand from alternative or renewable energy producers and government initiatives for carbon neutral energy. Declining energy prices, weaker economies or warm winters such as in 2014, 2015 and 2016 tempered the demand for wood chips resulting from initiatives by European governments to promote the use of wood as a carbon neutral energy. Over the long-term, we expect this non-traditional demand for fiber is likely to continue to remain strong.

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During the past few years, certain customers have endeavored to purchase pulp that is produced using fiber that meets certain recognized wood certification requirements from forest certification agencies like FSC, PEFC, SFI-CSA. If the fiber we purchase does not meet certain wood certifications required by customers, it may make it more difficult or prevent us from selling our pulp to such customers. The chain of custody wood certification process is a voluntary process which allows a company to demonstrate that they use forest resources in accordance with strict principles and standards in the areas of sustainable forest management practices and environmental management. In an effort to procure wood only from sustainably managed sources, we employ an FSC Chain of Custody protocol for controlled wood and PEFC certification, which requires tracking of fiber origins and preparing risk based assessments regarding the region and operator. In the areas where we operate, we are actively engaged in the further development of certification processes. Although wood certification requirements continue to evolve and are not consistent from jurisdiction to jurisdiction, we currently do not expect certification requirements to have a material adverse impact on our fiber procurement and pulp sales.

Offsetting some of the increases in demand for wood fiber have been initiatives to increase harvest levels in Germany, particularly from small private forest owners. We believe that Germany has the highest availability of softwood forests in Europe suitable for harvesting and manufacturing. We believe private ownership of such forests is approximately 48%. Many of these forest ownership stakes are very small and have been harvested at rates much lower than their rate of growth.

In 2016, our per unit fiber costs in Germany were 9% lower than in 2015, primarily as a result of a balanced wood market in Germany. In 2015, our per unit fiber costs in Germany decreased by approximately 17% due to the strength of the dollar and as a result of a generally balanced wood market. In 2014, our per unit fiber costs in Germany decreased by approximately 6% due to sawmills running at high rates, a stronger supply of logs and lower demand from pellet producers and board manufacturers.

We believe we are the largest consumer of wood chips and pulp logs in Germany and often provide the best long-term economic outlet for the sale of wood chips in Eastern Germany. We coordinate the wood procurement activities for our German mills to reduce overall personnel and administrative costs, provide greater purchasing power and coordinate buying and trading activities. This coordination and integration of fiber flows also allows us to optimize transportation costs, and the species and fiber mix for both mills. In addition, in 2016, we entered into a joint wood purchasing arrangement with another significant wood consumer in Europe, being the Mondi Group.

In 2016, the Rosenthal mill consumed approximately 1.8 million cubic meters of fiber. Approximately 66% of such consumption was in the form of sawmill wood chips and approximately 34% was in the form of pulp logs. The wood chips for the Rosenthal mill are sourced from approximately 33 sawmills located primarily in the states of Bavaria, Baden-Württemberg and Thüringia and primarily within a 300 kilometer radius of the Rosenthal mill. Within this radius, the Rosenthal mill is the largest consumer of wood chips. Given its location and size, the Rosenthal mill is often the best economic outlet for the sale of wood chips in the area. In 2016, approximately 67% of the fiber consumed by the Rosenthal mill was spruce and the remainder was pine. While fiber costs and supply are subject to cyclical changes largely in the sawmill industry, we expect that we will be able to continue to obtain an adequate supply of fiber on reasonably satisfactory terms for the Rosenthal mill due to its location and our long-term relationships with suppliers. We have not historically experienced any significant fiber supply interruptions at the Rosenthal mill.

Wood chips for the Rosenthal mill are normally sourced from sawmills under one-year contracts with quarterly adjustments for market pricing. Substantially all of our chip supply is sourced from suppliers with which we have long-standing relationships. Pulp logs are sourced from the state forest agencies in Thüringia, Saxony and Bavaria and from private and municipal forest owners. In addition, the Rosenthal mill buys relevant volumes from traders and via

imports from the Czech Republic and Poland.

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In 2016, the Stendal mill consumed approximately 3.3 million cubic meters of fiber. Approximately 29% of such fiber was in the form of sawmill wood chips and approximately 71% was in the form of pulp logs. The core wood supply region for the Stendal mill includes most of the Northern and Western part of Germany primarily within an approximate 300 kilometer radius of the mill. We also purchase wood chips from Southwestern and Southern Germany. The fiber consumed by the Stendal mill consisted of approximately 53% pine, 46% spruce and 1% other species in 2016. The Stendal mill has sufficient chipping capacity to fully operate solely using pulp logs, if required. We source pulp logs from private forest holders, municipal forest owners and from state forest agencies in Saxony-Anhalt, Mecklenburg-Western Pomerania, Saxony, Lower Saxony, North Rhine-Westphalia, Hesse, Brandenburg, Schleswig-Holstein, Rhineland Palatinate and the City of Berlin. The volumes are distributed at optimal costs between the mills. In addition, over the last three years, the Stendal mill also imported fiber from Poland and the Baltic Sea region.

The availability of fiber for the Celgar mill is in large part influenced by the strength of the lumber market. Lumber markets are primarily driven by U.S. housing starts and, to a lesser degree, demand from China.

In 2016, our Celgar mill's per unit fiber costs were 6% lower than in 2015, due to strong sawmilling activity in the Celgar mill's fiber basket. In 2015, our Celgar mill's per unit fiber costs were flat compared to 2014, as the strengthening of the dollar largely offset higher prices in local currency terms. In 2014, our Celgar mill's per unit fiber costs were 11% lower than in 2013, as a result of strong sawmill activity in the region.

In 2016, the Celgar mill consumed approximately 2.3 million cubic meters of fiber. Approximately 78% of such fiber was in the form of sawmill wood chips and the remaining 22% came from pulp logs processed through its woodroom or chipped by a third party. Celgar's woodroom is able to process about 40% of the mill's fiber needs. The source of fiber at the mill is characterized by a mixture of species (pine, douglas fir, hemlock, cedar and spruce) and the mill sources fiber from a number of Canadian and U.S. suppliers.

In 2016, the Celgar mill had access to approximately 27 different chip suppliers from Canada and the United States, representing approximately 78% of its total annual fiber requirements. The Celgar mill's woodroom and third party chippers supplied the remaining 22% of the mill's fiber requirements in 2016. Chips are purchased in Canada and the United States in accordance with chip purchase agreements. Generally, pricing is reviewed and adjusted periodically to reflect market prices. One of the longer-term contracts is a so-called "evergreen" agreement, where the contract remains in effect until one of the parties elects to terminate after providing the stipulated notice. All other contracts are generally for one year with quarterly adjustments or on three-month terms.

To secure the volume of pulp logs required by its woodroom, the Celgar mill has entered into pulp log supply agreements, which can range from three-month to one-year terms, with a number of different suppliers, many of whom are also contract chip suppliers to the mill. All of the pulp log agreements can be terminated by either party for any reason, upon seven days' written notice. The Celgar mill also purchased two non-renewable licenses at a cost of \$1.3 million, which will provide saw logs to sawmills in the area and pulp logs for the Celgar mill to use. The Celgar mill also bids on British Columbia timber sales from time to time. The Celgar mill has also commenced second pass harvesting in certain locales to increase harvesting of pulp logs that have traditionally been left as waste after harvesting operations.



**Table of Contents*****Labor***

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

***Energy***

Our energy is primarily generated from renewable carbon neutral sources, such as black liquor and wood waste. Our mills produce all of our energy requirements and generate excess energy which we sell to third party utilities. In 2016, we generated 1,812,646 MWh and sold 785,845 MWh of surplus energy. See also [Generation and Sales of Green Energy and Chemicals at our Mills](#) . We utilize fossil fuels, such as natural gas, primarily in our lime kilns and we use a limited amount for start-up and shut-down operations. Additionally, from time to time, mill process disruptions occur and we consume small quantities of purchased electricity and fossil fuels to maintain operations. As a result, all of our mills are subject to fluctuations in the prices for fossil fuels.

***Chemicals***

Our mills use certain chemicals which are generally available from several suppliers and sourcing is primarily based upon pricing and location. Our chemical costs have generally declined over the last three years through improved efficiencies and capital expenditures and the strength of the dollar.

In connection with our focus on the growing bio-energy market, we sell tall oil, a by-product of our production process which is used as both a chemical additive and as a green energy source. In 2016, we generated \$12.8 million from the sale of tall oil and other chemicals.

**Sales, Marketing and Distribution**

Our pulp revenues by geographic area are set out in the following table for the periods indicated:

<b>Revenues by Geographic Area</b>	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
	<b>(in thousands)</b>		
Germany	\$ 326,898	\$ 344,843	\$ 346,879
Italy	53,702	53,919	80,730
Other European Union countries <sup>(1)</sup>	173,585	210,218	250,952
United States	26,985	15,453	39,146
China	221,773	266,632	276,848
Other Asia	31,897	43,981	69,711
Other countries	12,488	11,191	9,366
Total <sup>(2)</sup>	\$ 847,328	\$ 946,237	\$ 1,073,632

(1) Excluding Germany and Italy.

(2) Excluding intercompany sales.

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The following charts illustrate the geographic distribution of our pulp revenues as a percentage of our total pulp revenues for the periods indicated:

<b>2016 Geographically Segmented Pulp Sales</b>	<b>2015 Geographically Segmented Pulp Sales</b>	<b>2014 Geographically Segmented Pulp Sales</b>
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\*Excluding Germany and Italy.

The distribution of our pulp sales by end use are set out in the following table for the periods indicated:

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
	<b>(in thousands of ADMTs)</b>		
Tissue	503	501	542
Specialty	209	227	205
Printing & Writing	663	716	705
Other	54	19	34
	<b>1,429</b>	<b>1,463</b>	<b>1,486</b>

Our global sales and marketing group is responsible for conducting all sales and marketing of the pulp produced at our mills and currently has approximately 15 employees. This group largely handles all European and North American sales directly. Sales to Asia are made directly or through commission agents overseen by our sales group. The global sales and marketing group handles sales to approximately 190 customers. We coordinate and integrate the sales and marketing activities of our German mills to realize on a number of synergies between them. These include reduced overall administrative and personnel costs and coordinated selling, marketing and transportation activities. We also coordinate sales from the Celgar mill with our German mills on a global basis, thereby providing our larger customers with seamless service across all major geographies. In marketing our pulp, we seek to establish long-term relationships by providing a competitively priced, high-quality, consistent product and excellent service. In accordance with customary practice, we maintain long-standing relationships with our customers, pursuant to which we periodically reach agreements on specific volumes and prices.

Our pulp sales are on customary industry terms. At December 31, 2016, we had no material payment delinquencies. In 2016, two customers through several of their operations accounted for 19% and 10%, respectively, of our pulp sales. In 2015, one customer through several of its operations accounted for 16% of our pulp sales. In 2014, one customer through several of its operations accounted for 13% of our pulp sales. We do not believe our pulp sales are dependent upon the activities of any single customer and the loss of any single customer would not have a material adverse effect on us.



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Our sales to tissue and specialty paper product manufacturers were approximately 50% of our pulp sales in 2016, 2015 and 2014. Generally tissue producer customers are not as sensitive to cyclical declines in demand caused by downturns in economic activity. The balance of our sales was to other paper product manufacturers.

**Transportation**

We transport our NBSK pulp generally by truck, rail and ocean carriers through third-party carriers. We have a small fleet of trucks in Germany that deliver some of our German mills' pulp.

Our German mills are currently the only significant market kraft pulp producers in Germany, which is the largest import market for kraft pulp in Europe. We therefore have a competitive transportation cost advantage compared to Canadian and Northern European pulp producers when shipping to customers in Europe. Due to the location of our German mills, we are able to deliver pulp to many of our customers primarily by truck and rail. Most trucks that deliver goods into Eastern Germany generally do not have significant backhaul opportunities as the region is primarily an importer of goods. We are therefore frequently able to obtain relatively low backhaul freight rates for the delivery of our products to many of our customers.

The Celgar mill's pulp is transported to customers by rail, truck and ocean carrier to ensure timely delivery. The majority of Celgar's pulp for overseas markets is initially delivered primarily by rail to the Port of Vancouver for shipment overseas by ocean carrier. Based in Western Canada, the Celgar mill is well positioned to service Asian customers. The majority of the Celgar mill's pulp for domestic markets is shipped by rail directly to the customer or to third party warehouses in the United States. In 2015, we established a logistics and reload center near Trail, British Columbia. The center provides us with additional warehouse space for our Celgar mill and greater transportation flexibility in terms of access to rail and trucking options.

In each of 2016, 2015 and 2014, outbound transportation costs comprised approximately 8%, 9% and 9%, respectively, of our total consolidated cost of sales. Generally, in recent years, our transportation costs have decreased due to the positive impact of a stronger dollar, decreases in fuel costs and higher shipping capacity. We have also taken initiatives to target sales to the most freight logical customers.

**Capital Expenditures**

We have continued to make capital investments designed to increase pulp, green energy and chemical generation, reduce costs and improve efficiency and environmental performance at our mills. The improvements made at our mills over the years have increased the competitive position of our facilities.

Total capital expenditures at our mills (excluding any related governmental grants) are set out in the following table for the periods indicated:

	Year Ended December 31,		
	2016	2015	2014
	(in thousands of dollars)		
Rosenthal	\$ 15,167	\$ 15,690	\$ 16,624
Stendal	7,801	18,490	8,700
Celgar	19,558	12,356	9,288

Total	\$	42,526	\$	46,536	\$	34,612
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Capital investments at the Rosenthal mill in 2016 related to a railcar acceptance system for logs and a lime kiln retrofit. In 2015, they related to a wastewater reduction project consisting of an evaporation plant upgrade and completion of an automated chip storage project and, in 2014, they related primarily to the automated chip storage project and a tall oil project.

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Capital investments at the Stendal mill in 2016 related to a wastewater reduction project consisting of an evaporation plant upgrade and a project to reduce chloride levels in the process water. In 2015 and 2014, they related primarily to the evaporation plant upgrade.

Certain of our capital investment programs in Germany were partially financed through government grants made available by German federal and state governments. Under legislation adopted by the federal and certain state governments of Germany, government grants are provided to qualifying businesses operating in Eastern Germany to finance capital investments. The grants are made to encourage investment and job creation. For example, the government grants received in connection with our main capital project completed at the Stendal mill in 2013 require us to maintain the employment of core employees for five years after completion of the project, among certain other terms. Previously, government grants were available for up to 35% of the cost of qualified investments. These grants at the 35% of cost level required that at least one permanent job be created for each 0.5 million (\$0.5 million) of capital investment eligible for such grants and that such jobs be maintained for a period of five years from the completion of the capital investment project. Generally, government grants are not repayable by a recipient unless such recipient fails to complete the proposed capital investment or, if applicable, fails to create or maintain the requisite amount of jobs or comply with other applicable terms. In the case of such failure, the government is entitled to revoke the grants and seek repayment unless such failure resulted from material unforeseen market developments beyond the control of the recipient, in which case the government may refrain from reclaiming previous grants. Pursuant to legislation in effect at the time, the Stendal mill recorded approximately \$350.0 million of government grants. We believe that we are currently in compliance in all material respects with all of the terms and conditions governing the government grants we have received in Germany. See Item 3. Legal Proceedings .

The following table sets out, as at the dates indicated, the effect of government grants on the recorded value of such assets in our Consolidated Balance Sheets:

	<b>2016</b>	<b>As at December 31, 2015</b>	<b>2014</b>
		<b>(in thousands)</b>	
Property, plant and equipment, gross amount less amortization	\$ 971,462	\$ 1,015,569	\$ 1,188,195
Less: government grants less amortization	(233,186)	(253,178)	(305,045)
Property, plant and equipment, net (as shown on the Consolidated Balance Sheet)	\$ 738,276	\$ 762,391	\$ 883,150

The following table sets forth, as at the dates indicated, the gross amount of all government grants we have received and capitalized in our balance sheet, the associated amortization and the resulting net balance we include in our property, plant and equipment:

	<b>2016</b>	<b>As at December 31, 2015</b>	<b>2014</b>
		<b>(in thousands)</b>	
Government grants gross <sup>(1)</sup>	\$ 467,260	\$ 475,142	\$ 532,696
Less: Accumulated amortization	(234,074)	(221,964)	(227,651)

Government grants less accumulated amortization	\$ 233,186	\$ 253,178	\$ 305,045
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(1) Grants were received in euros and Canadian dollars and amounts change when translated into dollars as a result of changes in currency exchange rates.



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

In 2016, capital investments at the Celgar mill included new wood harvesting equipment, a logistics and reload center and other maintenance projects. In 2015, they included the logistics and reload center and other maintenance projects and, in 2014, they included a new chip screening project, the logistics and reload center and maintenance projects.

In January 2014, we commenced the implementation of a new enterprise resource planning, or ERP , system to replace our existing business software applications at an estimated cost of \$12.0 million. The project was designed to be completed in stages and is expected to be substantially completed in 2017. The ERP system installation will replace a suite of existing legacy systems which, while functional, will begin becoming obsolete in the near future. The ERP solution introduces state-of-the-art, end-to-end business solutions that will provide automation for most aspects of our business.

Excluding costs for projects financed through government grants, capital expenditures, including ERP expenditures, in 2017 are expected to be approximately \$48.0 million, comprised principally of approximately:

\$13.0 million at the Rosenthal mill for a project to reduce wastewater fees and other projects;

\$17.0 million at the Stendal mill for a project to reduce wastewater fees and other projects; and

\$18.0 million at the Celgar mill for maintenance and other projects.

## **Innovation**

We are well positioned to capitalize on our expertise with fiber and its processing to expand our product mix and into new markets. Accordingly, we have a number of initiatives focused on developing innovative new products that are based on derivatives of the kraft pulping process. Currently these derivatives are focused in two broad categories:

the further refinement of materials contained in black liquor, the extractive chemical and lignin containing compounds that are a result of the kraft pulping process; and

the further refinement of cellulose materials that are currently the basis of NBSK pulp.

We are working on some of these initiatives on our own and some with industry associations and others with joint venture partners. Currently, one of the better-developed of these projects is a cellulose derivative generally referred to in the industry as cellulose filaments . Cellulose filaments are the result of a new process that unbinds the individual filaments that make up a cellulose fiber. In northern softwoods, there are approximately 1,000 filaments making up a single fiber. The filaments resulting from this patented process are long, ribbon-like structures that have unique strength characteristics similar to other chemical derivatives, such as aramids. We believe that this material may have commercial potential in many applications, including strength enhancers, solution stabilizers and specialty solutions for numerous other industries.

We are part of an industry association that has made considerable progress in developing a particular manufacturing process. We, along with other member companies, including certain other NBSK producers, have license rights to further develop and market existing intellectual property registered under patent to our industry association. The association and one of its member companies have constructed a

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pilot production facility and we have access to its product for development purposes. While there remains much work to be done, we continue to be encouraged with the results to date and intend to continue to expend resources to develop this technology, both individually and in joint development arrangements with third parties. We currently estimate expenditures totaling approximately \$1.0 million in 2017.

Such research and development is still at an early stage and there has been no commercialization of any products to date. We currently estimate it may take about three years before we can determine if product applications can be commercialized. However, there can be no assurance that such research and development will ever result in commercialization or the production or sales of any products by us at a profit or at all.

We have also worked with suppliers to develop new customized forms of railcars in Germany designed to better handle the transportation of logs and chips to our German mills. These customized cars are larger than existing ones and are designed to reduce transportation and handling costs at our German mills. In 2016, we leased and received about 200 such railcars.

We have also worked with equipment suppliers to develop innovative logging equipment to permit us to effect second pass harvesting in the fiber procurement area for the Celgar mill. Such equipment includes customized processing and chipping equipment and trailers for haulage.

## **Environmental**

Our operations are subject to a wide range of environmental laws and regulations, dealing primarily with water, air and land pollution control. We devote significant management and financial resources to comply with all applicable environmental laws and regulations. In particular, the operation of our plants is subject to permits, authorizations and approvals and we have to comply with certain emission limits. Compliance with these requirements is monitored by local authorities and non-compliance may result in administrative orders, fines or closures of the non-compliant mill. Our total capital expenditures on environmental projects at our mills were approximately \$2.9 million in 2016, approximately \$19.4 million in 2015 and approximately \$6.1 million in 2014. In 2017, capital expenditures for environmental projects, principally comprised of projects to reduce wastewater fees and upgrade the effluent system at our German mills, are expected to be approximately \$21.0 million.

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

Under German state environmental rules relating to effluent discharges, industrial users are required to pay wastewater fees based upon the amount of their effluent discharge. These rules also provide that an industrial user which undertakes environmental capital expenditures and lowers certain effluent discharges to prescribed levels may offset the amount of these expenditures against the wastewater fees that they would otherwise be required to pay. We expect capital investment programs and other environmental initiatives at our German mills will continue to offset the wastewater fees that are payable and we believe they will ensure that our operations continue in substantial compliance with prescribed standards.

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



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The Rosenthal mill has a relatively modern biological wastewater treatment and oxygen bleaching facility. We have significantly reduced our levels of absorbable organic halogen discharge at the Rosenthal mill and we believe the Rosenthal mill's absorbable organic halogen and chemical oxygen discharges are in compliance with the standards currently mandated by the German government.

Management believes that, as the Stendal mill is a state-of-the-art facility, it will be able to continue to operate in compliance with the applicable environmental requirements.

Management further believes that Celgar will continue to operate in substantial compliance with the requirements of all applicable environmental laws and regulations. However, on September 16, 2016, our Celgar mill had a valve issue at its sewage treatment plant which was promptly notified to environmental authorities and was resolved on the same day. Prior to such resolution, the mill discharged effluent into a river which was toxic to fish. After investigation, our Celgar mill received a written warning from the federal environmental authority under the *Fisheries Act*. While we believe the issue is resolved and completed, we can provide no assurance that a governmental authority will not take any further actions regarding the same, including monetary penalties.

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

## **Climate Change**

Over the past several years, changing weather patterns and climatic conditions due to natural and man-made causes have added to the unpredictability and frequency of natural disasters, such as hurricanes, earthquakes, hail storms, wildfires, snow storms and ice storms, which could also affect our operations, including variations in the cost and availability of raw materials, such as fiber. However, as there are differing scientific studies relating to the severity, extent and speed at which climate change is occurring, we cannot identify and predict all of the consequences of climate change on our business and operations.

The effects and perceived effects of climate change and social and governmental responses have created both opportunities and negative consequences for our business.

The focus on climate change has generated a substantial increase in demand and in legislative requirements for carbon neutral or green energy in both Europe and, increasingly, in North America. Pulp mills consume wood residuals, being wood chips and pulp logs, as the base raw material for their production process. Wood chips are residuals left over from lumber production and pulp logs are generally lower quality logs left over from logging that are unsuitable for the production of lumber.

As part of their production process, our mills take wood residuals and process them through a digester where cellulose is separated from the wood to be used in pulp production and the remaining residuals, called black liquor, are used for green energy production. As a result of their use of wood residuals and because our mills generate combined heat and power in a process known as cogeneration, they are efficient producers of energy. This energy is carbon neutral and produced from a renewable source. Our relatively modern mills generate a substantial amount of energy that is surplus to their operational requirements.

These factors, along with governmental initiatives in respect of renewable or green energy legislation, have provided business opportunities for us to enhance our generation and sales of green energy to regional utilities.

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We are constantly exploring other initiatives to enhance our generation and sales of surplus green energy and chemical by-products. Other potential opportunities that may result from climate change include:

the expansion of softwood forests and increased growth rates for such forests;

more intensive forestry practices and timber salvaging versus harvesting standing timber;

greater demand for sustainable energy and cellulosic biomass fuels; and

additional governmental incentives and/or legislative requirements to enhance biomass energy production.

At this time, we cannot predict which, if any, of these potential opportunities will be realized by us or their economic effect on our business.

While all of the specific consequences to our business from climate change are not predictable, the most visible adverse consequence to date is that the focus on renewable energy has created greater demand and competition for wood residuals or fiber from renewable energy producers like the pellet industry in Germany.

In Germany, the price and supply of wood residuals have been affected by an increasing demand from alternative or renewable energy producers and governmental initiatives for carbon neutral energy. Declining energy prices, weaker economies or warm winters such as in 2016, 2015 and 2014 temper the demand for wood chips resulting from initiatives by European governments to promote the use of wood as a carbon neutral energy. Over the long term, this non-traditional demand for fiber is expected to remain strong in Europe. Additionally, the growing interest and focus in British Columbia for renewable green energy is also expected to create additional competition for such fiber in that region over time. Such additional demand for wood residuals may increase the competition and prices for wood residuals over time.

Governmental action or legislation may also have an important effect on the demand and prices for wood residuals. As governments pursue green energy initiatives, they risk creating incentives and demand for wood residuals from renewable energy producers that cannibalizes or adversely affects traditional users, such as lumber and pulp and paper producers. We are continually engaged in dialogue with governments to educate and try to ensure potential initiatives recognize the traditional and continuing role of our mills in the overall usage of forestry resources and the economies of local communities.

Other potential negative consequences from climate change that over time may affect our business include:

a greater susceptibility of northern softwood forests to disease, fire and insect infestation;

the disruption of transportation systems and power supply lines due to more severe storms;

the loss of fresh water transportation for logs and pulp due to lower water levels;

decreases in the quantity and quality of processed water for our mill operations;

the loss of northern softwood forests in areas in sufficient proximity to our mills to competitively acquire fiber; and

lower harvest levels decreasing the supply of harvestable timber and, as a consequence, wood residuals.



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### **Human Resources**

We currently employ approximately 1,486 people. We have approximately 1,025 employees working in our German operations, including our wood procurement, transportation and sales subsidiaries. In Canada, we have approximately 461 employees, of which 21 are employed at our Vancouver, British Columbia, office.

Rosenthal employs approximately 439 people, the majority of whom are bound by a collective agreement. In July 2015, the Rosenthal mill revised its collective agreement for a two-year period until June 2017. The agreement provided for an initial 2.4% wage increase and a subsequent increase of 2.4% in September 2016.

Stendal employs approximately 579 people, the majority of which are bound by a collective agreement. In 2011, Stendal entered into a seven-year collective agreement, effective July 2011 and expiring in 2018. Since, prior to entering into this collective agreement, Stendal's employees had relatively lower wages compared to their peers at other German pulp mills, this agreement provided for an approximately 5.5% wage increase in 2012 and a further 2.5% minimum annual wage increase from 2013 to 2015, with no wage increases from 2016 to the agreement's expiry in 2018.

Celgar employs approximately 440 people, the majority of which are bound by a collective agreement. Celgar entered into a five-year collective agreement with its hourly workers in 2012, which expires in April 2017. The agreement provided for lump sum payments of C\$3,750 for all active employees in 2012 and 2013 and wage increases of 2.0%, 2.5% and 3.0% in each of 2014, 2015 and 2016, respectively.

We consider the relationships with our employees to be good. Although no assurances can be provided, we have not had any significant work stoppages at any of our operations and we would therefore expect to enter into new labor agreements with our workers when the current labor agreements expire without any significant work stoppages.

Our directors and senior managers have extensive experience in the pulp and forestry industries, along with experienced managers at all of our mills. Our management has a proven track record of implementing new initiatives and capital projects in order to reduce costs throughout our operations as well as identifying and harnessing new revenue opportunities.

### **Description of Certain Indebtedness**

The following summarizes certain material provisions of: (i) our 2019, 2022 and 2024 Senior Notes; (ii) our Stendal Revolving Credit Facility; (iii) our credit facilities related to our Rosenthal mill; and (iv) the Celgar Working Capital Facility. The summaries are not complete and are qualified by reference to the applicable documents and the applicable amendments to such documents on file with the SEC and incorporated by reference herein.

#### ***2019, 2022 and 2024 Senior Notes***

In November 2014, we issued \$250.0 million in aggregate principal amount of 7.000% Senior Notes due 2019, referred to as the 2019 Senior Notes, and \$400.0 million in aggregate principal amount of 7.750% Senior Notes due 2022, referred to as the 2022 Senior Notes, to refinance our previously outstanding 9.50% Senior Notes due 2017 and Stendal's two senior project finance facilities.

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In 2016, we repurchased and cancelled \$23.0 million in aggregate principal amount of our 2019 Senior Notes and, in January 2017, we announced the redemption of all of our remaining 2019 Senior Notes, being \$227.0 million in aggregate principal amount, with the net proceeds of an issuance of \$225.0 million in aggregate principal amount of 6.500% senior notes due 2024, referred to as the 2024 Senior Notes and, together with the 2019 Senior Notes and the 2022 Senior Notes, the 2019, 2022 and 2024 Senior Notes, and cash on hand. The 2024 Senior Notes were issued on February 3, 2017 and our outstanding 2019 Notes will be redeemed on March 1, 2017, subject to our deposit with the paying agent of sufficient funds to pay the redemption price, being \$1,035.00 per \$1,000.00 of principal amount redeemed, plus accrued and unpaid interest to, but not including the redemption date.

The 2019 Senior Notes were to mature on December 1, 2019 and interest on the 2019 Senior Notes is payable semi-annually in arrears on each June 1 and December 1. The 2022 Senior Notes mature on December 1, 2022 and interest on the 2022 Senior Notes is payable semi-annually in arrears on each June 1 and December 1. Interest is payable to holders of record of the 2022 Senior Notes on the immediately preceding May 15 and November 15 and is computed on the basis of a 360-day year consisting of twelve 30-day months. The 2024 Senior Notes mature on February 1, 2024 and interest on the 2024 Senior Notes is payable semi-annually in arrears on each February 1 and August 1. Interest is payable to holders of record of the 2024 Senior Notes on the immediately preceding January 15 and July 15 and is computed on the basis of a 360-day year consisting of twelve 30-day months.

Commencing December 1, 2017, the 2022 Senior Notes will become redeemable at our option at a price equal to 105.813% of the principal amount redeemed and declining ratably on December 1 of each year thereafter to 100.000% on or after December 1, 2020. Commencing February 1, 2020, the 2024 Senior Notes will become redeemable at our option at a price equal to 103.250% of the principal amount redeemed and declining ratably on December 1 of each year thereafter to 100.000% on or after February 1, 2022.

The indentures governing the 2019, 2022 and 2024 Senior Notes contain covenants limiting, among other things, our ability and the ability of our restricted subsidiaries to: incur additional indebtedness or issue preferred stock; pay dividends or make other distributions to our shareholders; purchase or redeem capital stock or subordinated indebtedness; make investments; create liens; incur restrictions on the ability of our restricted subsidiaries to pay dividends or make other payments to us; sell assets; consolidate or merge with or into other companies or transfer all or substantially all of our assets; and engage in transactions with affiliates. As of December 31, 2016, all of our subsidiaries were restricted subsidiaries.

The 2019, 2022 and 2024 Senior Notes are unsecured and are not guaranteed by any of our operating subsidiaries, all of which are located outside the United States. Our obligations under the 2019, 2022 and 2024 Senior Notes rank: effectively junior in right of payment to all of our existing and future secured indebtedness, to the extent of the assets securing such indebtedness, and all indebtedness and liabilities of our subsidiaries; equal in right of payment with all of our existing and future unsecured senior indebtedness; and senior in right of payment to any of our future subordinated indebtedness.

As at December 31, 2016, \$227.0 million in aggregate principal amount of 2019 Senior Notes and \$400.0 million in aggregate principal amount of 2022 Senior Notes were outstanding. Upon completion of the redemption of the 2019 Senior Notes and as a result of the issuance of the 2024 Notes, \$400.0 million in aggregate principal amount of 2022 Senior Notes and \$225.0 million in aggregate principal amount of 2024 Senior Notes will be outstanding.

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### *Stendal Revolving Credit Facility*

Our Stendal mill s 75.0 million revolving credit facility, referred to as the Stendal Revolving Credit Facility , with a syndicate of four banks as original lenders matures in October 2019. The principal terms of the Stendal Revolving Credit Facility are as follows:

The total availability under the facility is 75.0 million.

The facility matures on the earlier of October 31, 2019 and one month prior to the stated maturity of the 2019 Senior Notes.

The facility may be utilized in the form of cash advances or advances by letters of credit or bank guarantees of up to 5.0 million. Borrowings accrue interest at a rate of Euribor plus a 3.50% margin. Fees of 2.25% per annum are payable on issued but undrawn letters of credit and bank guarantees. There is a commitment fee of 1.10% per annum payable on unused availability.

The facility is secured by a first ranking registered security interest on the inventories and receivables of Stendal. All shareholder loans made by Mercer Inc. to Stendal are subordinated to the indebtedness under the facility.

The facility contains financial maintenance covenants which are tested semi-annually on June 30 and December 31, which require Stendal to maintain (i) a leverage ratio of net debt (excluding shareholder loans) to EBITDA of not greater than 2.50:1.00, (ii) an interest coverage ratio (EBITDA to interest expense) of not less than 1.20:1.00 and (iii) a current ratio (current assets to current liabilities) of at least 1.10:1.00.

Stendal is permitted under the facility to make (i) distributions for regularly scheduled interest payments on its shareholder loans from Mercer Inc. in an amount of up to \$23.0 million per year, provided it maintains pro forma liquidity (availability under the facility plus unencumbered cash) of at least 20.0 million and no event of default is occurring and (ii) other distributions to Mercer Inc. semi-annually, provided it maintains pro forma liquidity of at least 20.0 million, no event of default is occurring and it has (A) a leverage ratio (excluding shareholder loans) of not greater than 2.50:1.00, (B) a trailing six-month interest coverage ratio of at least 1.40:1.00 and (C) a current ratio of at least 1.25:1.00.

Pursuant to the facility, Stendal has provided 4.1 million as at December 31, 2016 as partial cash collateral for variable-to-fixed interest rate swaps, referred to as the Stendal Interest Rate Swap Contract , and such contract shares *pari passu* in the security for the Stendal Revolving Credit Facility. For further information related to the Stendal Interest Rate Swap Contract, see Item 7A. Quantitative and Qualitative Disclosures About Market Risk and the notes to our consolidated financials included herein.

The facility contains other customary restrictive covenants which, among other things, govern the ability of Stendal to incur liens, sell assets, incur indebtedness, make investments, enter into joint ventures, change its business and issue, repurchase or redeem shares. The facility also contains customary events of default.

As at December 31, 2016, the total amount of funds available under the Stendal Revolving Credit Facility was 75.0 million.

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**Table of Contents*****Rosenthal Credit Facilities***

Our Rosenthal mill has the following credit facilities:

a 25.0 million revolving working capital facility which we extended in 2016 to mature in October 2019, referred to as the Rosenthal Loan Facility. The Rosenthal Loan Facility consists of a revolving credit facility which may be utilized by way of cash advances or advances by way of letter of credit or bank guarantees. The interest payable on cash advances is Euribor plus 2.95%, plus certain other costs incurred by the lenders in connection with the facility. Each cash advance is to be repaid on the last day of the respective interest period and in full on the termination date and each advance by way of a letter of credit or bank guarantee shall be repaid on the applicable expiry date of such letter of credit or bank guarantee. An interest period for cash advances shall be one, three or six months or any other period as Rosenthal and the lenders may determine. There is also a 0.90% per annum commitment fee on the unused and uncanceled amount of the revolving facility which is payable semi-annually in arrears. This facility is secured by a first ranking security interest on the inventories and receivables of Rosenthal. It also provides Rosenthal with a hedging facility relating to the hedging of the interest, currency and pulp prices as they affect Rosenthal pursuant to a strategy agreed to by Rosenthal and the lender from time to time. As at December 31, 2016, 3.1 million was supporting bank guarantees, leaving approximately 21.9 million available under this facility; and

a 5.0 million revolving credit facility for our Rosenthal mill which bears interest at the rate of the three-month Euribor plus 2.5%. Borrowings under this agreement are secured by certain land at the Rosenthal mill. The facility matures in December 2018. As at December 31, 2016, 3.2 million was supporting bank guarantees.

As at December 31, 2016, the total amount of funds available under the Rosenthal credit facilities was 23.7 million.

***Celgar Working Capital Facility***

Our Celgar mill's C\$40.0 million revolving credit facility with a Canadian bank, referred to as the Celgar Working Capital Facility, matures in May 2019. The facility is available by way of: (i) Canadian and U.S. denominated advances, which bear interest at a designated prime rate per annum, (ii) banker's acceptance equivalent loans, which bear interest at the applicable Canadian dollar banker's acceptance plus 1.50% per annum and (iii) dollar LIBOR advances, which bear interest at LIBOR plus 1.50% per annum. The facility includes a C\$3.0 million sub-limit for letters of credit. Celgar is required to pay 0.25% per annum on unused availability under the facility and 1.25% per annum on issued but undrawn letters of credit. The availability of the facility is subject to a borrowing base limit that is based on the Celgar mill's eligible receivable and inventory levels from time to time. The Celgar Working Capital Facility is secured by, among other things, a first priority charge on the inventories and receivables of Celgar. The facility is guaranteed by Mercer Inc. and all material subsidiaries of Celgar. The facility includes a springing financial covenant, which is measured when excess availability under the facility is less than C\$5.0 million and which requires Celgar to comply with a 1.10:1.00 fixed charge coverage ratio. The facility also contains restrictive covenants which, among other things, restrict the ability of Celgar to declare and pay dividends, incur indebtedness, incur liens and make payments on subordinated debt. The facility contains customary events of default.

As at December 31, 2016, the total amount of funds available under the Celgar Working Capital Facility was C\$38.3 million.



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**Internet Availability and Additional Information**

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

All websites referred to herein are inactive textual references only, meaning that the information contained on such websites is not incorporated by reference herein and you should not consider information contained on such websites as part of this document unless expressly specified.

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**ITEM 1A. RISK FACTORS**

The statements in this Risk Factors section describe material risks to our business and should be considered carefully. You should review carefully the risk factors listed below, as well as those factors listed in other documents we file with the SEC. In addition, these statements constitute our cautionary statements under the Private Securities Litigation Reform Act of 1995. Our disclosure and analysis in this annual report on Form 10-K and in our annual report to shareholders contain some forward-looking statements that set forth anticipated results based on management's current plans and assumptions.

There are a number of important factors, many of which are beyond our control that could cause actual conditions, events or results to differ significantly from those described in the forward-looking statements. These factors include, but are not limited to, the following:

our business is highly cyclical;

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

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

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

we face intense competition in our markets;

we are exposed to currency exchange rate fluctuations;

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

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

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



future acquisitions may result in additional risks and uncertainties in our business;

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

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

we are subject to risks related to our employees;

we are dependent on key personnel;

we may experience material disruptions to our production (including as a result of, among other things, planned and unplanned maintenance downtime);

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

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

our insurance coverage may not be adequate;

we rely on third parties for transportation services;

our new ERP system may cost more than expected, be delayed, fail to perform as planned and interrupt operational transactions during and following the implementation, which could adversely affect our operations and results of operations;

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

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

the price of our common stock may be volatile;

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

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

we are exposed to interest rate fluctuations.

From time to time, we also provide forward-looking statements in other materials we release as well as oral forward-looking statements. Such statements give our current expectations or forecasts of future events; they do not relate strictly to historical or current facts.

Statements in the future tense, and all statements accompanied by terms such as may, will, believe, project, estimate, assume, intend, design, anticipate, plan, should and variations thereof and similar terms are in forward-looking statements as defined by federal securities law. You can find examples of these statements throughout this annual report on Form 10-K, including in the description of business in Item 1. Business and Item 7.

Management's Discussion and Analysis of Financial Condition and Results of Operations. While these forward-looking statements reflect our best estimates when made, the following risk factors could cause actual results

to differ materially from estimates or projections.

We intend that all forward-looking statements we make will be subject to safe harbor protection of the federal securities laws pursuant to Section 27A of the *Securities Act of 1933*, as amended and Section 21E of the *Securities Exchange Act of 1934*, as amended.

You should consider the limitations on, and risks associated with, forward-looking statements and not unduly rely on the accuracy of predictions contained in such forward-looking statements. As noted above, these forward-looking statements speak only as of the date when they are made. We do not undertake any obligation to update forward-looking statements to reflect events, circumstances, changes in expectations, or the occurrence of unanticipated events after the date of those statements. Moreover, in the future, we may make forward-looking statements that involve the risk factors and other matters described in this document as well as other risk factors subsequently identified.

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***Our business is highly cyclical in nature.***

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

Industry capacity can fluctuate as changing industry conditions can influence producers to idle production capacity or permanently close mills. In addition, to avoid substantial cash costs in idling or closing a mill, some producers will choose to operate at a loss, sometimes even a cash loss, which can prolong weak pricing environments due to oversupply. Oversupply of our products can also result from producers introducing new capacity in response to favorable pricing trends. Certain integrated pulp and paper producers have the ability to discontinue paper production by idling their paper machines and selling their NBSK pulp production on the market, if market conditions, prices and trends warrant such actions.

Currently, there have been publicly announced significant increases to expand chemical pulp capacity worldwide. Producers have announced projects to increase hardwood kraft pulp capacity by an aggregate of about 3.2 million ADMTs in 2017 and 2018, primarily in South America and Asia. Further capacity increases of about 0.7 million ADMTs have been announced for 2019. This increase in bleached hardwood kraft pulp is largely targeted at the growing demand for pulp in developing markets, particularly in China, by producers of tissues, specialty papers and packaging. If such additional bleached hardwood kraft pulp supply is not absorbed by such demand growth, as a result of generally lower prices for bleached hardwood kraft pulp, this supply increase could put downward pressure on NBSK pulp prices.

Producers have also announced increases to NBSK pulp capacity in 2017 and 2018 of an estimated 1.9 million ADMTs, along with another 0.6 million ADMTs of southern softwood and fluff pulp capacity. Further net capacity increases of NBSK and southern and fluff pulp capacity of about 0.3 million ADMTs have been announced for 2019. At this time, we cannot predict how much of the publicly announced capacity will come on line and when. If such new capacity, particularly for NBSK pulp, is not absorbed in the market or offset by curtailments or closures of older, high-cost NBSK pulp mills, the increase could put downward pressure on NBSK pulp prices and materially adversely affect our results of operations, margin, and profitability.

Demand for pulp has historically been determined primarily by general global macro-economic conditions and has been closely tied to overall business activity. NBSK pulp prices have been and are likely to continue to be volatile and can fluctuate widely over time. Between 2007 and 2016, European list prices for NBSK pulp have fluctuated between a low of approximately \$575 per ADMT in 2009 to a high of \$1,030 per ADMT in 2011.

A producer's actual sales price realizations are list prices net of customer discounts, rebates and other selling concessions. Over the last three years, these have increased as producers compete for customers and sales. Our sales price realizations may also be affected by NBSK price movements between the order and shipment dates.

Accordingly, prices for pulp are driven by many factors outside our control, and we have little influence over the timing and extent of price changes, which are often volatile. Because market conditions beyond our control determine the price for pulp, prices may fall below our cash production costs, requiring us to either incur short-term losses on product sales or cease production at one or more of our mills.



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Therefore, our profitability depends on managing our cost structure, particularly raw materials which represent a significant component of our operating costs and can fluctuate based upon factors beyond our control. If the prices of our products decline, or if prices for our raw materials increase, or both, our results of operations and cash flows could be materially adversely affected.

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

As demand for pulp has principally historically been determined by general global macro-economic activities, demand and prices for our product have historically decreased substantially during economic slowdowns. A significant economic downturn may affect our sales and profitability. Further, our suppliers and customers may also be adversely affected by an economic downturn. Additionally, restricted credit and capital availability restrains our customers ability or willingness to purchase our products resulting in lower revenues. Depending on their severity and duration, the effects and consequences of a global economic downturn could have a material adverse effect on our liquidity and capital resources, including our ability to raise capital, if needed, and otherwise negatively impact our business and financial results.

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

As of December 31, 2016, we had an aggregate principal amount of \$627.0 million of indebtedness outstanding. 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 for working capital, capital expenditures, general corporate and other purposes or to fund future operations may not be available on terms favorable to us or at all;

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

increasing our vulnerability to current and future adverse economic and industry conditions;

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;

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;

causing us to offer debt or equity securities on terms that may not be favorable to us or our shareholders;

limiting our flexibility in planning for, or reacting to, changes and opportunities in our business and our industry; and

our level of indebtedness increases the possibility that we may be unable to generate cash sufficient to pay the principal or interest due in respect of our indebtedness.

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The indentures that govern our 2019, 2022 and 2024 Senior Notes and our bank credit facilities contain restrictive covenants which impose operating and other restrictions on us and our subsidiaries. These restrictions will affect, and in many respects will limit or prohibit, our ability to, among other things, incur or guarantee additional indebtedness, pay dividends or make distributions on capital stock or redeem or repurchase capital stock, make investments or acquisitions, create liens and enter into mergers, consolidations or transactions with affiliates. The terms of our indebtedness also restrict our ability to sell certain assets, apply the proceeds of such sales and reinvest in our business.

Certain of the agreements governing our indebtedness have covenants that require us to maintain prescribed financial ratios and tests. Failure to comply with such covenants could result in events of default and could have a material adverse effect on our liquidity, results of operations and financial condition.

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 extent to which we can successfully implement our business strategy. We cannot assure you that we will be able to implement our strategy fully or that the anticipated results of our strategy will be realized. Over the next several years, we will require financing to refinance maturing debt obligations (unless extended), and such refinancing may not be available on favorable terms or at all.

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

Our main raw material is fiber in the form of wood chips and pulp logs and represented approximately 60% of our cash production costs in 2016. Fiber is a commodity and both prices and supply are cyclical. Fiber pricing is subject to regional market influences and our costs of fiber may increase in a region as a result of local market shifts. The cost of wood chips and pulp logs is primarily affected by the supply and demand for lumber. Demand for these raw materials is generally determined by the volume of pulp and paper products produced globally and regionally. Governmental regulations related to the environment, forest stewardship and green or renewable energy can also affect the supply of fiber. In Germany, governmental initiatives to increase the supply of renewable energy have led to more renewable energy projects in Europe, including Germany. Demand for wood residuals from such energy producers, combined with lower harvesting rates, has generally put upward pressure on prices for wood residuals, such as wood chips, in Germany and its neighboring countries. This has resulted in higher fiber costs for our German mills and such trend could continue to put further upward pressure on wood chip prices. Wood chip supply in Germany was stable during the course of 2015 and 2016 due to stable sawmill production and lower demand from pellet producers and board manufacturers; however, there is no assurance that wood chip supply will continue to be stable or that supply will not be reduced or that fiber costs will not increase in the future.

Similarly, North American sawmill activity declined significantly during the recession, reducing the supply of chips and availability of pulp logs to our Celgar mill. Additionally, North American energy producers are exploring the viability of renewable energy initiatives and governmental initiatives in this field are increasing, all of which could lead to higher demand for sawmill residual fiber, including chips. A recovery in U.S. housing starts, which commenced in the latter part of 2012 and has continued through 2016, resulted in increased sawmill activity. This increased the supply of wood chips for the Celgar mill and reduced its need for pulp logs, which are generally a higher cost for the mill than wood chips. Sawmill activity was stable in Canada during 2015 and 2016; however, there is no assurance that sawmill activity will continue to remain stable or that fiber prices will not increase in the future.





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The 2006 Softwood Lumber Agreement which governed softwood lumber exports from Canada to the United States expired in 2015 and a one-year post-expiration period during which the United States agreed not to impose trade sanctions expired in October 2016. In December 2016, the U.S. Department of Commerce initiated investigations, which could result in countervailing and anti-dumping duties on Canadian softwood lumber exports to the United States commencing in the second and third quarters of 2017, respectively. Canada may appeal any such duties to the World Trade Organization. It is uncertain when or if the United States and Canada may settle a new agreement and what terms or restrictions it may contain. Any duties or other restrictions imposed on Canadian softwood lumber exports by the United States could negatively impact Canadian sawmill production in our Celgar mill's supply area and result in reduced availability and increased costs for wood chips for the mill. While we believe this may be partially offset by increased wood chip supply from U.S. sawmills and pulp log availability, we cannot currently predict the overall effect on our Celgar mill's overall fiber costs.

Availability of fiber may be further limited by adverse responses to and prevention of wildfires, weather, insect infestation, disease, ice storms, wind storms, flooding and other natural causes. In addition, the quantity, quality and price of fiber we receive could be affected by man-made causes such as those resulting from industrial disputes, material curtailments or shut-down of operations by suppliers, government orders and legislation (including new taxes or tariffs). Any or a combination of these can affect fiber prices in a region.

The cyclical nature of pricing for fiber represents a potential risk to our profit margins if pulp producers are unable to pass along price increases to their customers or we cannot offset such costs through higher prices for our surplus energy.

We do not own any timberlands or have any material long-term governmental timber concessions and we currently have few long-term fiber contracts at our German operations. Fiber is available from a number of suppliers and we have not historically experienced material supply interruptions or substantial sustained price increases. However, our requirements have increased and may continue to do so as we expand capacity through capital projects or other efficiency measures at our mills. As a result, we may not be able to purchase sufficient quantities of these raw materials to meet our production requirements at prices acceptable to us during times of tight supply. 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 fiber, we are, to a lesser extent, dependent on the supply of certain chemicals and other inputs used in our production facilities. Any disruption in the supply of these chemicals or other inputs could affect our ability to meet customer demand in a timely manner and could harm our reputation. Any material increase in the cost of these chemicals or other inputs could have a material adverse effect on our business, results of operations, financial condition and cash flows.

### ***We face intense competition in our markets.***

We sell our pulp globally, with a large percentage sold in Europe, Asia and North America. The markets for pulp are highly competitive. A number of other global companies compete in each of these markets and no company holds a dominant position. Our pulp is considered a commodity because many companies produce similar and largely standardized products. 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. Prices for our products are affected by many factors outside of our control and we have no influence over the timing and extent of price changes, which are often volatile. Our ability to maintain satisfactory



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margins depends, in large part, on managing our costs, particularly raw material and energy costs which represent significant components of our operating costs and can fluctuate based upon factors beyond our control.

The global pulp market has historically been characterized by considerable swings in prices which have and will result in variability in our earnings.

***We are exposed to currency exchange rate fluctuations.***

We have manufacturing operations in Germany and Canada. Most of the operating costs and expenses of our German mills are incurred in euros and those of our Celgar mill in Canadian dollars. However, the majority of our sales are in products quoted in dollars. Our results of operations and financial condition are reported in dollars. As a result, our costs generally benefit from a strengthening dollar but are adversely affected by a decrease in the value of the dollar relative to the euro and to the Canadian dollar. Such declines in the dollar relative to the euro and the Canadian dollar reduce our operating margins and the cash flow available to fund our operations and to service our debt. This could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Further, while a strengthening dollar generally lowers our costs and expenses, it increases the cost of NBSK pulp to our customers and generally puts downward pressure on pulp prices and reduces our energy and chemical sales revenues as they are sold in euros and Canadian dollars.

Although we report in dollars, we hold certain assets and liabilities, including our mills, in euros and Canadian dollars. We translate foreign denominated assets and liabilities into dollars at the rate of exchange on the balance sheet date. Equity accounts are translated using historical exchange rates. Unrealized gains or losses from these translations are recorded in our other comprehensive income (loss) and do not affect our net earnings, operating income or Operating EBITDA.

Certain intercompany dollar advances between Mercer Inc. and its foreign subsidiaries are held in euros and Canadian dollars. When such advances are translated by the subsidiaries into dollars at the end of each reporting period, the gains or losses thereon are reflected in net earnings.

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

Our operations are subject to numerous environmental laws and regulations as well as permits, guidelines and policies relating to the protection of the environment. These laws, regulations, permits, guidelines and policies govern, among other things:

unlawful discharges to land, air, water and sewers;

waste collection, storage, transportation and disposal;

hazardous waste;

dangerous goods and hazardous materials and the collection, storage, transportation and disposal of such substances;

the clean-up of unlawful discharges;

land use planning;

municipal zoning; and

employee health and safety.

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In addition, as a result of our operations, we may be subject to remediation, clean-up or other administrative orders or amendments to our operating permits, and we may be involved from time to time in administrative and judicial proceedings or inquiries. Future orders, proceedings or inquiries could have a material adverse effect on our business, financial condition and results of operations. Environmental laws and land use laws and regulations are constantly changing. New regulations or the increased enforcement of existing laws could have a material adverse effect on our business and financial condition. In addition, compliance with regulatory requirements is expensive, at times requiring the replacement, enhancement or modification of equipment, facilities or operations. There can be no assurance that we will be able to maintain our profitability by offsetting any increased costs of complying with future regulatory requirements.

We are subject to liability for environmental damage at the facilities that we own or operate, including damage to neighboring landowners, residents or employees, particularly as a result of the contamination of soil, groundwater or surface water and especially drinking water. The costs of such liabilities can be substantial. Our potential liability may include damages resulting from conditions existing before we purchased or operated these facilities. We may also be subject to liability for any offsite environmental contamination caused by pollutants or hazardous substances that we or our predecessors arranged to transport, treat or dispose of at other locations. In addition, we may be held legally responsible for liabilities as a successor owner of businesses that we acquire or have acquired. Except for Stendal, our facilities have been operating for decades and we have not done invasive testing to determine whether or to what extent any such environmental contamination exists. As a result, these businesses may have liabilities for conditions that we discover or that become apparent, including liabilities arising from non-compliance with environmental laws by prior owners. Because of the limited availability of insurance coverage for environmental liability, any substantial liability for environmental damage could materially adversely affect our results of operations and financial condition.

We have incurred, and we expect to continue to incur, significant capital, operating and other expenditures as a result of complying with applicable environmental laws and regulations.

Further, enactment of new environmental laws or regulations, changes in existing laws or regulations or the interpretation of these laws and regulations might require significant capital expenditures. We may be unable to generate sufficient funds or access other sources of capital to fund unforeseen environmental liabilities or expenditures.

### ***Our business is subject to risks associated with climate change and social and government responses thereto.***

Our operations and those of our suppliers are subject to climate change variations which can impact the productivity of forests, the abundance of species, harvest levels and lumber. Further, over the last few years, changing weather patterns and climate conditions due to natural and man-made causes have added to the frequency and unpredictability of natural disasters like earthquakes, storms, wildfires and snow and ice storms. One or a combination of these factors could adversely affect our fiber supply which is our largest cash production cost. There are differing scientific studies and opinions relating to the severity, extent and speed at which climate change is or may be occurring around the world. As a result, we are currently unable to identify and predict all of the specific consequences of climate change on our business and operations.

Further, governmental initiatives in response to climate change also have an impact on operations.

In Germany, government and social focus on and demand for carbon neutral or green energy has created greater demand and competition for the wood residuals or fiber that is consumed by our pulp mills as part of their production process. This has helped drive up the cost of fiber for German mills. In



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addition, further or new governmental initiatives or legislation may also increase both the demand and prices for wood residuals. As governments pursue green energy initiatives, they may implement financial, tax, pricing or other legislated incentives for renewable energy producers that cannibalize or materially adversely affect fiber supplies for existing traditional users, such as lumber and pulp and paper producers.

Such additional demand for wood residuals and/or governmental initiatives may materially increase the competition and prices for wood residuals over time. This could increase our fiber costs and/or restrict our ability to acquire fiber at competitive prices or at all during times of shortages. If our fiber costs increase and we cannot pass on these costs to our customers or offset them through higher prices for our sales of surplus energy, it will negatively affect our operating margins, results of operations and financial position. If we cannot obtain the fiber required to operate our mills, we may have to curtail and/or shut down production. This could have a material adverse effect on operations, financial results and financial position.

Other potential risks to our business from climate change include:

a greater susceptibility of northern softwood forests to disease, fire and insect infestation, which could diminish fiber availability;

the disruption of transportation systems and power supply lines due to more severe storms;

the loss of fresh water transportation for logs and pulp due to lower water levels;

decreases in the quantity and quality of processed water for our mill operations;

the loss of northern softwood forests in areas in sufficient proximity to our mills to competitively acquire fiber; and

lower harvest levels decreasing the supply of harvestable timber and, as a consequence, wood residuals.

The occurrence of any or a combination of these events could have a material adverse effect on our operations and/or financial results.

***Our operations require substantial capital and we may be unable to maintain adequate capital resources to provide for such capital requirements.***

Our business is capital intensive and requires that we regularly incur capital expenditures to maintain our equipment, improve efficiencies and, as a result of changes to environmental regulations that require capital expenditures, bring our operations into compliance with such regulations. In addition, we may approve projects in the future that will require significant capital expenditures. Increased capital expenditures could have a material adverse effect on our cash flow and our ability to satisfy our debt obligations. If our available cash resources and cash generated from operations are not sufficient to fund our operating needs and capital expenditures, we would have to obtain additional



funds from borrowings or other available sources or reduce or delay our capital expenditures. Our indebtedness could adversely affect our financial health, limit our operations or impair our ability to raise additional capital. If this occurs, we may not be able to obtain additional funds on favorable terms or at all. If we cannot maintain or upgrade our equipment as may be required from time to time, we may become unable to manufacture products that compete effectively. An inability to make required capital expenditures in a timely fashion could have a material adverse effect on our growth, business, financial condition or results of operations.

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***Future acquisitions may result in additional risks and uncertainties in our business.***

In order to grow our business, we may seek to acquire additional assets or companies. Our ability to pursue selective and accretive acquisitions will be dependent on management's ability to identify, acquire, and develop suitable acquisition targets in both new and existing markets. In pursuing acquisition and investment opportunities, we face competition from other companies having similar growth strategies, many of which may have substantially greater resources than us. Competition for these acquisitions or investment targets could result in increased acquisition or investment prices, higher risks and a diminished pool of businesses or assets available for acquisition.

Acquisitions also frequently result in recording of goodwill and other intangible assets, which are subject to potential impairments in the future that could have a material adverse effect on our operating results. Furthermore, the costs of integrating acquired businesses (including restructuring charges associated with the acquisitions, as well as other acquisition costs, such as accounting fees, legal fees and investment banking fees) could significantly impact our operating results.

Although we perform diligence on the businesses we purchase, in light of the circumstances of each transaction, an unavoidable level of risk remains regarding the actual condition of these businesses. We may not be able to ascertain the value or understand the potential liabilities of the acquired businesses and their operations until we assume operating control of the assets and operations of these businesses.

Furthermore, any future acquisitions of businesses or facilities could entail a number of risks, including:

problems with the effective integration of operations;

inability to maintain key pre-acquisition business relationships;

increased operating costs;

exposure to substantial unanticipated liabilities; and

difficulties in realizing projected efficiencies, synergies and cost savings.

In addition, geographic and other expansions, acquisitions or joint ventures may require significant managerial attention, which may be diverted from our other operations. If we are unsuccessful in overcoming these risks, our business, financial condition or results of operations could be materially and adversely affected.

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

Credit rating agencies rate our debt securities on factors that include our operating results, actions that we take, their view of the general outlook for our industry and their view of the general outlook for the economy. Actions taken by the rating agencies can include maintaining, upgrading or downgrading the current rating or placing the company on a watch list for possible future downgrading. Downgrading the credit rating of our debt securities or placing us on a

watch list for possible future downgrading could limit our access to the credit markets, increase our cost of financing and have an adverse effect on the market price of our securities, including the 2019, 2022 and 2024 Senior Notes.

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### ***We rely on government grants and participate in German statutory energy programs.***

We currently benefit from a subsidized capital expenditure program as a result of German federal and state government grants. Should either the German federal or state governments be prohibited from honoring legislative grants, or should we be required to repay any such legislative grants, this may have a material adverse effect on our business, financial condition, results of operations and cash flow.

Since 2005, our German mills have received emission allowances under the EU ETS. Since our German mills receive stipulated special tariffs under the Renewable Energy Act, the amount of emissions allowances granted to our German mills under the EU ETS has been reduced and, as a result, from time to time, we purchase emission allowances in order to meet statutory requirements. Additionally, such emission allowances are subject to statutory amendment or change in the future.

In 2014, in response to an investigation by the European Commission into whether portions of the Renewable Energy Act constituted unpermitted state aid, the German government amended the Renewable Energy Act. After such amendment, our German mills continued to sell green energy into the market at stipulated prices or tariffs and were exempted, as existing installations, from certain surcharges on the consumption of energy that they generate, or auto-generation. The German government further amended the Renewable Energy Act effective January 1, 2017, so that funding for renewable energy is to be allocated through an auction system, primarily to create a competitive bidding process for new installations of wind, solar and biomass energy. However, the amendments provide that existing pulp mills, including our German mills, are ineligible for such auction process and instead will have their tariffs renewed upon expiry of their initial 20-year terms for a further 10-year period, based upon the price received in the last year prior to renewal regressing at a rate of 8% per annum. Our Rosenthal mill's initial 20-year tariff expires on December 31, 2019 and our Stendal mill's initial 20-year tariff expires on December 31, 2024. Such 10-year extensions for such mills have been notified by the German government to the European Commission for review for compliance with applicable state aid rules. While we currently expect they will become effective, we can provide no assurance that they will be permitted under EU rules. As a result, we cannot currently predict the effect of promulgated amendments to the Renewable Energy Act on our German mills' sale or consumption of energy.

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

### ***We are subject to risks related to our employees.***

The majority of our employees are unionized and we have collective agreements in place with our employees at all of our mills. Although we have not experienced any material work stoppages in the past, there can be no assurance that we will be able to negotiate acceptable collective agreements or other satisfactory arrangements with our employees upon the expiration of our collective agreements, including our collective agreement with hourly workers at the Celgar mill which expires in April 2017. This could result in a strike or work stoppage by the affected workers. The registration or renewal of the collective agreements or the outcome of our wage negotiations could result in higher wages or benefits paid to union members. Additionally, changing demographics may make it more difficult for us to recruit skilled employees in the future. Accordingly, we could experience a significant disruption of our operations or higher ongoing labor costs, which could have a material adverse effect on our business, financial condition, results of operations and cash flow. In addition, whenever we seek to reduce workforce at any of our mills, the affected mill's labor force could seek to hinder or delay such actions, we could incur material severance or other costs, and our operations could be disrupted.



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***We are dependent on key personnel.***

Our future success depends, to a large extent, on the efforts and abilities of our executive and senior mill operating officers. Such officers are industry professionals many of whom have operated through multiple business cycles. Our officers play an integral role in, among other things:

sales and marketing;

reducing operating costs;

identifying capital projects which provide a high rate of return; and

prioritizing expenditures and maintaining employee relations.

The loss of one or more of our officers could make us less competitive in these areas, which could materially adversely affect our business, financial condition, results of operations and cash flows. We do not maintain any key person life insurance for any of our executive or senior mill operating officers.

***We may experience material disruptions to our production.***

A material disruption at one of our manufacturing facilities could prevent us from meeting customer demand, reduce our pulp and energy sales and/or negatively impact our results of operations. Any of our mills could cease operations unexpectedly due to a number of events, including:

unscheduled maintenance outages;

prolonged power failures;

equipment failure;

employee errors or failures;

design error or employee or contractor error;

chemical spill or release;

explosion of a boiler;

disruptions in the transportation infrastructure, including roads, bridges, railway tracks, tunnels, canals and ports;

fires, floods, earthquakes or other natural catastrophes;

prolonged supply disruption of major inputs;

labor difficulties;

capital projects that require temporary cost increases or curtailment of production; and

other operational problems.

Any such downtime or facility damage could prevent us from meeting customer demand for our products and/or require us to make unplanned capital expenditures. If any of our facilities were to incur significant downtime, our ability to meet our production capacity targets and satisfy customer requirements would be impaired and could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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

We review the carrying value of long-lived assets for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Should the markets for our products deteriorate or should we decide to invest capital differently or should other cash flow assumptions change, it is possible that we will be required to record non-cash impairment charges in the future that could have a material adverse effect on our results of operations.

***We may incur losses as a result of unforeseen or catastrophic events, including the emergence of a pandemic, terrorist attacks or natural disasters.***

The occurrence of unforeseen or catastrophic events, including the emergence of a pandemic or other widespread health emergency (or concerns over the possibility of such an emergency), terrorist attacks or natural disasters, could create economic and financial disruptions and could lead to operational difficulties (including travel limitations) that could impair our ability to manage or operate our business and adversely affect our results of operations.

***Our insurance coverage may not be adequate.***

We have obtained insurance coverage that we believe would ordinarily be maintained by an operator of facilities similar to our mills. Our insurance is subject to various limits and exclusions. Damage or destruction to our facilities could result in claims that are excluded by, or exceed the limits of, our insurance coverage. Additionally, the weak global and financial markets have also reduced the availability and extent of credit insurance for our customers. If we cannot obtain adequate credit insurance for our customers, we may be forced to amend or curtail our planned operations which could negatively impact our sales revenues, results of operations and financial position.

***We rely on third parties for transportation services.***

Our business primarily relies upon third parties for the transportation of pulp to our customers, as well as for the delivery of our raw materials to our mills. Our pulp and raw materials are principally transported by truck, barge, rail and sea-going vessels, all of which are highly regulated. Increases in transportation rates can also materially adversely affect our results of operations.

Further, if our transportation providers fail to deliver our pulp in a timely manner, it could negatively impact our customer relationships and we may be unable to manufacture pulp in response to customer orders or sell our pulp at full value. Also, if any of our transportation providers were to cease operations, we may be unable to replace them at a reasonable cost. The occurrence of any of the foregoing events could materially adversely affect our results of operations.



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***Our new ERP system may cost more than expected, be delayed, fail to perform as planned and interrupt operational transactions during and following the implementation, which could adversely affect our operations and results of operations.***

In January 2014, we commenced the implementation of a new ERP solution to replace our existing business software applications at a total estimated cost of \$12.0 million. The project was designed to be completed in stages and is expected to be substantially completed in 2017. Such projects are inherently complex, resource intensive and lengthy. As a result, we could experience unplanned or unforeseen issues that could adversely affect the project, our business and/or our results of operations, including:

costs of implementation that materially exceed our expectation;

delays in the go-live of one or more of the stages of the project, resulting in additional costs or time for completion;

errors in implementation resulting in errors in the commencement or reporting of business transactions;

failure in the deliverables of our key partners, suppliers and implementation advisors, resulting in an inferior product, reduced business efficacy and the project not providing expected benefits;

deficiencies in the training of employees in the use of the new solution, resulting in errors in the recording of data or transactions, leading to delays in input deliveries and production impairment;

a control failure during or post implementation, which may result in a material weakness in our internal controls over financial reporting; and

other implementation issues leading to delays and impacts on our business.

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

In 2002, Stendal entered into the Stendal Interest Rate Swap Contract to fix interest payments under its indebtedness until 2017, which prevented Stendal from benefiting from the general decline in interest rates that ensued. Because we effectively fixed the rate on Stendal's indebtedness under such contract, the value of our derivative position moves inversely to interest rates. The Stendal Interest Rate Swap Contract remains in place after we refinanced Stendal's indebtedness in 2014.

We also periodically use other derivatives related to currency exchange rates, pulp prices and energy prices.

We record unrealized gains or losses on our derivative instruments when they are marked to market at the end of each reporting period and realized gains or losses on them when they are settled. These unrealized and realized gains and losses can materially impact our operating results for any reporting period.

If any of the variety of instruments and strategies we utilize is not effective, we may incur losses which may have a material adverse effect on our business, financial condition, results of operations and cash flow. The purpose of our derivative activity may also be considered speculative in nature; we do not use these instruments with respect to any pre-set percentage of revenues or other formula, but either to augment our potential gains or reduce our potential losses depending on our perception of future economic events and developments.

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***Failures or security breaches of our information technology systems could disrupt our operations and negatively impact our business.***

We use information technologies to securely manage our operations and various business functions. We rely on various technologies to process, store and report on our business and to communicate electronically between our facilities, personnel, customers and suppliers. We also use information technologies to process financial information and results of operations for internal reporting purposes and to comply with regulatory, legal and tax requirements. Despite our security design and controls, and those of our third party providers, our information technology systems may be vulnerable to a variety of interruptions, including during the process of upgrading or replacing software, databases or components thereof, natural disasters, terrorist attacks, telecommunications failures, computer viruses, cyber-attacks, hackers, unauthorized access attempts and other security issues or may be breached due to employee error, malfeasance or other disruptions. Any such interruption or breach could result in operational disruptions or the misappropriation of sensitive data that could subject us to civil and criminal penalties, litigation or have a negative impact on our reputation. There can be no assurance that such disruptions or misappropriations and the resulting repercussions will not negatively impact our cash flows and materially affect our results of operations or financial condition.

***The price of our common stock may be volatile.***

The market price of our common stock may be influenced by many factors, some of which are beyond our control, including those described above and the following:

actual or anticipated fluctuations in our operating results or our competitors' operating results;

announcements by us or our competitors of new products, capacity changes, significant contracts, acquisitions or strategic investments;

our growth rate and our competitors' growth rates;

the financial market and general economic conditions;

changes in stock market analyst recommendations regarding us, our competitors or the forest products industry generally or lack of analyst coverage of our common stock;

sales of common stock by our executive officers, directors and significant shareholders;

changes in accounting principles; and

changes in laws and regulations.

In addition, there has been significant volatility in the market price and trading volume of securities of companies operating in the forest products industry that often has been unrelated to the operating performance of particular companies. Some companies that have had volatile market prices for their securities have had securities litigation brought against them. If litigation of this type is brought against us, it could result in substantial costs and would divert management's attention and resources.

*A small number of our shareholders could significantly influence our business.*

There are a few significant shareholders of our common stock who own a substantial percentage of the outstanding shares of our common stock. These few significant shareholders, either individually or acting together, may be able to exercise significant influence over matters requiring shareholder approval,

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including the election of directors and approval of significant corporate transactions, such as a merger or other sale of the company or our assets. This concentration of ownership may make it more difficult for other shareholders to effect substantial changes in the company, may have the effect of delaying, preventing or expediting, as the case may be, a change in control of the company, and may adversely affect the market price of our common stock. Further, the possibility that one or more of these significant shareholders may sell all or a large portion of their common stock in a short period of time could adversely affect the trading price of our common stock. Also, the interests of these few shareholders may not be in the best interests of all shareholders.

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

As a result of our international sales and operations, we are subject to trade and economic sanctions and other restrictions imposed by the United States, Canada and other governments or organizations, including prohibitions in the United States against foreign competitors (including our operating subsidiaries) receipt of certain unlawful foreign governmental benefits. We are also subject to the U.S. *Foreign Corrupt Practices Act*, the Canadian *Corruption of Foreign Public Officials Act* and other anti-bribery laws that generally bar bribes or unreasonable gifts to foreign governments or officials. Changes in trade sanctions laws could restrict our business practices, including cessation of business activities in sanctioned countries or with sanctioned entities, and may result in modifications to compliance programs. Violations of these laws or regulations could result in sanctions including fines, loss of authorizations needed to conduct our international business, the imposition of tariffs or duties, and other penalties, which could adversely impact our business, operating results and financial condition.

***We are exposed to interest rate fluctuations.***

Interest on borrowings under our revolving credit facilities are at floating rates. As a result, increases in interest rates will increase our costs of borrowing and reduce our operating margins.

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**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

We own the Rosenthal, Stendal and Celgar mills and the underlying properties.

***Rosenthal mill.*** The Rosenthal mill is situated on a 230 acre site in the town of Blankenstein in the state of Thuringia, approximately 300 kilometers south of Berlin. The Saale river flows through the site of the mill. In late 1999, we completed a major capital project which converted the Rosenthal mill to the production of kraft pulp. It is a single line mill with a current annual production capacity of approximately 360,000 ADMTs of kraft pulp. The mill is self-sufficient in steam and electrical power. Some excess electrical power which is constantly generated is sold to the regional power grid. The facilities at the mill include:

an approximately 425,000 square feet fiber storage area;

debarking and chipping facilities for pulp logs;

an approximately 700,000 square feet roundwood yard;

a fiber line, which includes a Kamyr continuous digester and bleaching facilities;

a pulp machine, which includes a dryer, a cutter and a baling line;

an approximately 60,000 square feet finished goods storage area;

a chemical recovery line, which includes a recovery boiler, evaporation plant, recausticizing plant and lime kiln;

a fresh water plant;

a wastewater treatment plant; and

a power station with a turbine capable of producing 57 MW of electrical power from steam produced by the recovery boiler and a power boiler.

**Stendal Mill.** The Stendal mill is situated on a 200 acre site owned by Stendal that is part of a larger 1,250 acre industrial park near the town of Stendal in the state of Saxony-Anhalt, approximately 300 kilometers north of the Rosenthal mill and 130 kilometers west of Berlin. The mill is adjacent to the Elbe river and has access to harbor facilities for water transportation. The mill is a single line mill with a current annual design production capacity of approximately 660,000 ADMTs of kraft pulp. The Stendal mill is self-sufficient in steam and electrical power. Some excess electrical power which is constantly being generated is sold to the regional power grid. The facilities at the mill include:

an approximately 740,000 square feet fiber and roundwood storage area;

debarking and chipping facilities for pulp logs;

a fiber line, which includes ten SuperBatch digesters and bleaching facilities;

a pulp machine, which includes a dryer, a cutter and a baling line;

an approximately 105,000 square feet finished goods storage area;

a chemical recovery line, which includes a recovery boiler, evaporation plant, recausticizing plant and lime kiln;

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a fresh water plant;

a wastewater treatment plant; and

a power station with two turbines capable of producing 148 MW of electrical power.

***Celgar Mill.*** The Celgar mill is situated on a 400 acre site near the city of Castlegar, British Columbia. The mill is located on the south bank of the Columbia River, approximately 600 kilometers east of the port city of Vancouver, British Columbia, and approximately 32 kilometers north of the Canada-U.S. border. The city of Seattle, Washington is approximately 650 kilometers southwest of Castlegar. The Celgar mill is a single line mill with a current annual production capacity of approximately 520,000 ADMTs of kraft pulp. Internal power generating capacity resulting from the completion of the Celgar Energy Project in 2010 enables the Celgar mill to be self-sufficient in electrical power and to sell surplus electricity. The facilities at the Celgar mill include:

an approximately 25,000 square feet fiber storage area;

a woodroom containing debarking and chipping facilities for pulp logs;

a fiber line, which includes a dual vessel hydraulic digester, a two stage oxygen delignification system and a four stage bleach plant;

two pulp machines, which each include a dryer, a cutter and a baling line;

an approximately 28,000 square feet on-site finished goods storage area and an approximately 29,000 square feet off-site finished goods storage area;

a chemical recovery line, which includes a recovery boiler, evaporation plant, recausticizing plant and lime kiln;

a wastewater treatment system; and

a power station with two turbines capable of producing approximately 100 MW of electrical power.



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

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

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

Cooked pulp flows out of the digester and is washed and screened to remove most of the residual spent chemicals 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 approximately 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 used chemicals, collectively known as 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.

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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 residuals from sawmills and our woodrooms and residue generated by the effluent treatment system. Additionally, during times of upset, we may use natural gas to generate steam. The high pressure steam produced by the recovery and power boilers is used to power a turbine generator to generate electricity, low pressure steam coming off the turbine is then used to provide heat for the digesting and pulp drying processes.

***Other Properties.*** In addition, we own a logistics and reload center near Trail, British Columbia and lease offices in Vancouver, British Columbia, Berlin, Arneburg and Hamburg, Germany and Seattle, Washington.

The 5.0 million Rosenthal working capital facility is secured by certain land at the Rosenthal mill. The working capital loan facilities established for our three mills are secured by first charges against the inventories and receivables of the respective mills.

### **ITEM 3. LEGAL PROCEEDINGS**

In January 2012, we initiated a claim against the Government of Canada for breaches by it of its obligations under NAFTA. Our NAFTA claim relates to our investment in the Celgar mill and arises from the treatment of the Celgar mill's energy generation assets and operations by the Province of British Columbia, primarily through the actions of B.C. Hydro, a provincially owned and controlled enterprise, and the British Columbia Utilities Commission, a provincial government regulatory agency. Our NAFTA claim is against the Government of Canada, rather than the Province of British Columbia as, under NAFTA, the Canadian government is responsible for the actions of its provinces. Our NAFTA claim alleges that our Celgar mill has received unfair and discriminatory treatment regarding the mill's ability to purchase and sell energy compared to other pulp mills and entities that generate and sell electricity within the Province of British Columbia. Under our NAFTA claim, we are seeking approximately C\$250.0 million in damages consisting of past losses accruing since 2008 and the net present value of projected losses that would result from the ongoing application of discriminatory Provincial policies should the status quo remain unchanged. Our NAFTA claim was heard by a tribunal appointed pursuant thereto in 2015. We currently expect to receive a decision from the tribunal some time in 2017.

As a result of the inherent uncertainty of litigation, there can be no assurance whether we will be successful in such NAFTA claim and we cannot quantify the amount we may recover, if any, under such proceedings if we were successful.

We are also subject to routine litigation incidental to our business. We do not believe that the outcome of such litigation will have a material adverse effect on our business or financial condition.

### **ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

(a) *Market Information.* Our shares are quoted for trading on the NASDAQ Global Select Market under the symbol **MERC** and listed in dollars on the Toronto Stock Exchange under the symbol **MERC.U**. The following table sets forth the high and low sale prices of our shares on the NASDAQ Global Select Market for each quarter in the two-year period ended December 31, 2016:

<b>Fiscal Quarter Ended</b>	<b>High</b>	<b>Low</b>
<b>2016</b>		
March 31	\$ 9.54	\$ 5.95
June 30	\$ 10.42	\$ 7.13
September 30	\$ 8.94	\$ 7.03
December 31	\$ 10.75	\$ 7.60
<b>2015</b>		
March 31	\$ 15.50	\$ 11.87
June 30	\$ 15.95	\$ 13.00
September 30	\$ 14.21	\$ 8.28
December 31	\$ 11.68	\$ 8.80

(b) *Shareholder Information.* As at February 9, 2017, there were approximately 217 holders of record of our shares and a total of 64,694,138 shares were outstanding.

(c) *Dividend Information.* On February 8, 2017, our board of directors approved a quarterly dividend of \$0.115 per share to be paid to holders of our common stock on April 4, 2017 to shareholders of record on March 28, 2017.

In 2016, our board of directors approved four quarterly dividend payments of \$0.115 per share each, the first being paid on April 5, 2016, the second being paid on July 7, 2016, the third being paid on October 4, 2016 and the fourth being paid on January 4, 2017.

The further declaration and payment of dividends is at the discretion of our board of directors and will depend upon various factors, including our earnings, financial condition, restrictions imposed by our credit facilities and the terms of any other indebtedness that may be outstanding, cash requirements, future prospects and other factors deemed relevant by our board of directors. The indentures governing our 2019, 2022 and 2024 Senior Notes and our credit facilities limit our ability to pay dividends or make other distributions on capital stock. See Item 1. Business Description of Certain Indebtedness .

(d) *Equity Compensation Plans.* The following table sets forth information as at December 31, 2016 with respect to the shares of our common stock that may be issued under our existing equity compensation plans.

<b>Number of securities to be issued upon</b>	<b>Weighted-average exercise price of</b>	<b>Number of securities remaining available for</b>
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	<b>exercise of outstanding options, warrants and rights (a)</b>	<b>outstanding options, warrants and rights (b)</b>	<b>future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)</b>
<b>Plan Category</b>			
Equity compensation plans approved by shareholders	-(1)	\$ -	1,044,478 <sup>(2)</sup>
Equity compensation plans not approved by shareholders	-	\$ -	-

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- (1) Excludes 38,000 outstanding restricted shares which vest in 2017 and a maximum of 2,068,174 outstanding performance share units, 657,654 of which had vested as at December 31, 2016. The underlying shares of common stock relating to the vested performance share units were issued in February 2017. Of the remaining 1,410,520 performance share units, 433,728 will vest in 2017 and 976,792 will vest in 2018. The actual number of shares of common stock issued in respect of unvested performance share units will vary from 0% to 200% of performance share units granted, based upon achievement of performance objectives established for such awards.
- (2) Represents the number of shares of our common stock remaining available for issuance under the 2010 Plan as of December 31, 2016. Our 2010 Plan replaced the 2004 Plan and the 1992 Plan expired in 2008. Our 2010 Plan provides for options, restricted stock rights, restricted shares, performance shares, performance share units and stock appreciation rights to be awarded to employees, consultants and non-employee directors.
- (e) *Performance Graph.* The following graph shows a five-year comparison of cumulative total shareholder return, calculated on an assumed dividend reinvested basis, for our common stock, the NASDAQ Stock Market Index, referred to as the *NASDAQ Index*, and Standard Industrial Classification, or *SIC*, Code Index (SIC Code 2611 - pulp mills), referred to as the *Industry Index*. The graph assumes \$100 was invested in each of our common stock, the *NASDAQ Index* and the *Industry Index* on December 31, 2011. Data points on the graph are annual.

**Comparison of Cumulative Total Return**

	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
Mercer International Inc.	\$ 100.00	\$ 117.38	\$ 163.44	\$ 201.48	\$ 152.06	\$ 188.86
SIC Code Index	\$ 100.00	\$ 114.04	\$ 136.21	\$ 152.54	\$ 97.82	\$ 137.58
NASDAQ Stock Market Index	\$ 100.00	\$ 117.45	\$ 164.57	\$ 188.84	\$ 201.98	\$ 219.89

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA**

The following table sets forth selected historical financial and operating data as at and for the years indicated. Our consolidated financial statements as at and for the year ended December 31, 2012 were reported using the euro. Effective October 1, 2013, we changed our reporting currency to the dollar. With the change in reporting currency, all comparative financial information has been recast from euros to dollars to reflect our consolidated financial statements as if they had been historically reported in dollars, consistent with Accounting Standards Codification Topic 830. Certain balance sheet items for 2015, 2014, 2013 and 2012 have been reclassified as a result of our adoption of Accounting Standards Update 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, and Accounting Standards Update 2015-17, *Balance Sheet Classification of Deferred Taxes*.

The following selected financial data are qualified in their entirety by, and should be read in conjunction with, our consolidated financial statements and related notes contained in this annual report and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations .

	<b>Year Ended December 31,</b>				
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>(in thousands, other than per share and per ADMT amounts)</b>				
<b>Statement of Operations Data</b>					
Revenues					
Pulp	\$ 847,328	\$ 946,237	\$ 1,073,632	\$ 996,187	\$ 979,770
Energy and chemicals	84,295	86,967	101,480	92,198	92,966
	\$ 931,623	\$ 1,033,204	\$ 1,175,112	\$ 1,088,385	\$ 1,072,736
Costs and expenses	\$ 817,880	\$ 867,520	\$ 1,013,314	\$ 1,056,725	\$ 1,009,714
Operating income	\$ 113,743	\$ 165,684	\$ 161,798	\$ 31,660	\$ 63,022
Interest expense	\$ (51,575)	\$ (53,891)	\$ (67,516)	\$ (69,156)	\$ (71,767)
Foreign exchange gain (loss) on intercompany debt	\$ (1,140)	\$ (5,306)	\$ (4,777)	\$ 904	\$ -
Gain (loss) on derivative instruments	\$ (241)	\$ (935)	\$ 11,501	\$ 19,709	\$ 4,812
Other income (expenses)	\$ (1,323)	\$ (601)	\$ 3,186	\$ 311	\$ (179)
Net income (loss) <sup>(1)</sup>	\$ 34,943	\$ 75,502	\$ 113,154	\$ (26,375)	\$ (15,670)
Net income (loss) per share					
Basic	\$ 0.54	\$ 1.17	\$ 1.82	\$ (0.47)	\$ (0.28)
Diluted	\$ 0.54	\$ 1.17	\$ 1.81	\$ (0.47)	\$ (0.28)
Dividends declared per common share	\$ 0.46	\$ 0.23	\$ -	\$ -	\$ -
Weighted average shares outstanding					
Basic	64,631	64,381	62,013	55,674	55,597
Diluted	65,098	64,777	62,515	55,674	55,597
<b>Balance Sheet Data</b>					
Current assets	\$ 401,851	\$ 388,811	\$ 357,867	\$ 465,447	\$ 448,993
Current liabilities	\$ 93,170	\$ 104,421	\$ 115,503	\$ 180,259	\$ 179,876
Working capital	\$ 308,681	\$ 284,390	\$ 242,364	\$ 285,188	\$ 269,117
Total assets	\$ 1,158,708	\$ 1,182,817	\$ 1,306,229	\$ 1,531,908	\$ 1,546,977
Long-term liabilities	\$ 686,410	\$ 695,420	\$ 751,846	\$ 1,003,332	\$ 999,339
Total equity	\$ 379,128	\$ 382,976	\$ 438,880	\$ 348,317	\$ 367,762
<b>Other Data</b>					

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Pulp sales volume (ADMTs)	1,428.7	1,463.1	1,486.4	1,440.1	1,473.5
Pulp production (ADMTs)	1,428.4	1,458.0	1,485.0	1,444.5	1,468.3
Average pulp sales realizations (per ADMT) <sup>(2)</sup>	\$ 586	\$ 640	\$ 715	\$ 683	\$ 657

- (1) We do not report the effect of government grants relating to our assets in our income. These grants reduce the cost basis of the assets purchased. See Item 1. Business Capital Expenditures .
- (2) Sales realizations after customer discounts, rebates and other selling concessions. Incorporates the effect of pulp price variations occurring between the order and shipment dates.

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**NON-GAAP FINANCIAL MEASURES**

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

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

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

Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are that Operating EBITDA does not reflect: (i) our cash expenditures, or future requirements, for capital expenditures or contractual commitments; (ii) changes in, or cash requirements for, working capital needs; (iii) the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our outstanding debt; (iv) noncontrolling interests in our Stendal NBSK pulp mill operations prior to our acquisition of 100% of the economic interest of Stendal in September 2014; (v) the impact of realized or marked to market changes in our derivative positions, which can be substantial; and (vi) the impact of impairment charges against our investments or assets. Because of these limitations, Operating EBITDA should only be considered as a supplemental performance measure and should not be considered as a measure of liquidity or cash available to us to invest in the growth of our business. Because all companies do not calculate Operating EBITDA in the same manner, Operating EBITDA as calculated by us may differ from Operating EBITDA or EBITDA as calculated by other companies. We compensate for these limitations by using Operating EBITDA as a supplemental measure of our performance and by relying primarily on our GAAP financial statements.



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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis of our financial condition and results of our operations for the years ended December 31, 2016, 2015 and 2014 is based upon and should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this annual report. This annual report contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those indicated in forward-looking statements. See **Cautionary Note Regarding Forward-Looking Statements** and **Item 1A. Risk Factors**.

**Results of Operations**

***General***

We operate in the pulp business and our operations are located in Germany and Western Canada. Our mills have a current combined annual production capacity of approximately 1.5 million ADMTs of NBSK pulp and 305 MW of electrical generation.

Markets for NBSK pulp are global, cyclical and commodity based. Our financial performance depends on a number of variables that impact sales and production costs. Sales and production results for kraft pulp are influenced largely by the market price for NBSK pulp, fiber costs and foreign currency exchange rates. Kraft pulp prices are highly cyclical and primarily determined by the balance between supply and demand. Pricing and demand are influenced by global macro-economic conditions, changes in consumption and industry capacity, the level of customer and producer inventories and fluctuations in exchange rates. The average European list prices for NBSK pulp between 2007 and 2016 have fluctuated between a low of \$575 per ADMT in 2009 to a high of \$1,030 per ADMT in 2011.

Our financial performance is also impacted by changes in the dollar to euro and Canadian dollar exchange rates. Changes in currency rates affect our operating results because most of our operating costs at our German mills are incurred in euros. Most of our operating costs at the Celgar mill are in Canadian dollars. These costs do not fluctuate with the dollar to euro or Canadian dollar exchange rates. Thus, an increase in the strength of the dollar versus the euro and the Canadian dollar decreases our operating costs and increases our operating margins and income from operations. Conversely, a weakening of the dollar against the euro and the Canadian dollar tends to increase our operating costs and decrease our operating margins and income from operations. Our energy and chemical sales are made in local currencies and, as a result, decline in dollar terms when the dollar strengthens and increase when the dollar weakens.

As a corollary to changes in exchange rates between the dollar and the euro and Canadian dollar, a stronger dollar generally increases costs to our customers and results in downward pressure on prices. Conversely, a weakening dollar generally supports higher pulp pricing. However, there is invariably a time lag between changes in currency exchange rates and pulp prices. This lag can vary and is not predictable with any precision.

In 2016, a generally overall strong dollar benefited our costs and expenses, as they are incurred in euros and Canadian dollars.

In 2015, changes in foreign exchange had a very significant effect on revenues, costs and expenses and results of operations, as the dollar was 16% and 14% stronger against the euro and Canadian dollar, respectively, compared to 2014. This largely contributed to a 14% decrease in costs and expenses in 2015 compared to 2014.

In 2014, the dollar was flat against the euro, but 7% stronger against the Canadian dollar, compared to 2013. This contributed to a 4% decrease in costs and expenses in 2014 compared to 2013.



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In 2016, largely as a result of the strong dollar and weakening hardwood prices, NBSK prices declined by about 4% compared to 2015. At the end of 2016, the NBSK list price was approximately \$990 per ADMT in North America and \$810 and \$605 per ADMT in Europe and China, respectively. In 2015, although pulp markets and demand were generally stable, the appreciation and the strength of the dollar versus the euro and Canadian dollar resulted in list prices declining by about 8% compared to 2014. In 2014, generally strong markets resulted in average NBSK list prices being about 7% higher than the previous year.

Our pulp sales realizations are list prices, net of customer discounts, rebates and other selling commissions. Over the last three years, these discounts, rebates and commissions, particularly in Europe and North America, have increased as producers compete for customers and sales. Our sales to China are closer to a net price with significantly lower or little discounts and rebates.

Production and sales of surplus energy and chemicals are key revenue sources for us. In 2016, 2015 and 2014, our mills generated and sold 785,845 MWh, 814,966 MWh and 807,758 MWh, respectively, of surplus renewable energy. Initiatives to increase our generation and sales of surplus renewable energy, chemicals and other by-products will continue to be a key focus for us. Such further initiatives may require additional capital spending.

Surplus energy and chemicals are by-products of our pulp production and the volumes generated and sold are primarily related to the rate of pulp production. In 2016, our energy and chemical revenues declined from 2015 as a result of lower sales volumes. Prices for our energy and chemical sales are generally stable and unrelated to cyclical changes in pulp prices. As our energy and chemical sales are sold in the local currencies of our mills, the overall strength of the dollar largely contributed to a decline in revenues therefrom in 2015 compared to 2014.

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. Wood chip and pulp log costs are primarily affected by the supply of, and demand for, lumber and pulp, which are both highly cyclical. Higher fiber costs could affect producer profit margins if they are unable to pass along price increases to pulp customers or purchasers of surplus energy.

During the past few years, strong sawmilling activity in Germany, coupled with initiatives to increase harvest levels, particularly from small private forest owners, have contributed to a balanced wood market in Germany. A recovery in U.S. housing starts, which commenced in the latter part of 2012 and continued through 2016, resulted in increased sawmill activity in North America. This increased the supply of wood chips for the Celgar mill and reduced its need for pulp logs, which are generally a higher cost for the mill than wood chips.

In 2016, our per unit fiber costs were 8% lower than in 2015, primarily as a result of a balanced wood market in both Germany and the Celgar mill's fiber basket. In 2015, our per unit fiber costs were 14% lower than in 2014, as a result of the strength of the dollar against the euro and the Canadian dollar. In 2014, our per unit fiber costs decreased by approximately 7% from 2013, primarily as a result of lower average fiber prices in the markets from which our mills source their fiber and the strengthening of the dollar against the Canadian dollar.

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Production costs also depend on the total volume of production. High operating rates and production efficiencies permit us to lower our average per ADMT cost by spreading fixed costs over more units. Higher operating rates also permit us to increase our generation and sales of surplus renewable energy and chemicals. Our production levels are also dependent on, among other things, the number of days of maintenance downtime at our mills. The following table sets out the number of days (and ADMTs) of annual maintenance downtime at each of our mills for the periods indicated:

	Year Ended December 31,					
	2016		2015		2014	
	Days	ADMTs	Days	ADMTs	Days	ADMTs
	(in thousands, except numbers of days)					
Rosenthal	10	10.2	11	11.1	10	10.1
Stendal	15	26.7	15	28.1	4	7.5
Celgar	18	24.5	14	19.2	10	14.0
Total	43	61.4	40	58.4	24	31.6

Going forward in 2017, we have scheduled maintenance downtime of 36 days, or approximately 49,200 ADMTs. Unexpected maintenance downtime can be particularly disruptive in our industry.

Our product mix is also important because premium grades of NBSK pulp generally achieve higher prices and profit margins.

***Selected 2016 Highlights***

In 2016:

we achieved strong operating performance and generated \$185.7 million in Operating EBITDA\* and \$34.9 million in net income;

we continued to strengthen our balance sheet and increased our cash position to \$136.6 million from \$99.6 million and our working capital to \$308.7 million from \$284.4 million, respectively, from the start of the year;

overall, per unit fiber costs decreased by approximately 8% at our mills compared to 2015, primarily as a result of a balanced wood market and strong sawmilling activity in both Germany and the Celgar mill's fiber basket combined with steady progress on several cost reduction initiatives;

our board authorized a quarterly cash dividend of \$0.115 per share and we returned approximately \$29.7 million to our shareholders over the course of the year; and

we continued to reduce indebtedness and future debt service costs through the repurchase and cancellation of \$23 million of our 7.0% senior notes due 2019 and, in January 2017, we announced the redemption of our remaining 7.0% senior notes with the proceeds of an issuance of \$225 million 6.5% senior notes due 2024 and cash on hand.

\* See page 60 of this annual report on Form 10-K for a reconciliation of net income to Operating EBITDA.

**Table of Contents****Current Market Environment**

Demand from China and Europe was generally stable in 2016 and supply was generally balanced. However, the strength of the dollar contributed to downward pressure on pulp prices during the year. In 2016, pulp prices in North America were marginally higher than in 2015 while prices in Europe and China decreased by about 6% compared to 2015. At the end of 2016, list prices in North America were approximately \$990 per ADMT and list prices in Europe and China were approximately \$810 and \$605 per ADMT, respectively.

As at December 31, 2016, the NBSK pulp market was generally balanced with world producer inventories at about 32 days supply. In addition, we expect to see continued growth in NBSK demand in emerging markets, particularly in China, driven by increasing strong demand from tissue producers.

**Summary Financial Highlights**

	Year Ended December 31,		
	2016	2015	2014
	(in thousands, other than percent and per share amounts)		
Pulp revenues	\$ 847,328	\$ 946,237	\$ 1,073,632
Energy and chemical revenues	\$ 84,295	\$ 86,967	\$ 101,480
Operating income	\$ 113,743	\$ 165,684	\$ 161,798
Operating EBITDA <sup>(1)</sup>	\$ 185,727	\$ 234,017	\$ 239,810
Operating EBITDA margin <sup>(1)</sup>	20%	23%	20%
Foreign exchange loss on intercompany debt	\$ (1,140)	\$ (5,306)	\$ (4,777)
Gain (loss) on derivative instruments	\$ (241)	\$ (935)	\$ 11,501
Income tax benefit (provision)	\$ (24,521)	\$ (29,449)	\$ 16,774
Net income	\$ 34,943	\$ 75,502	\$ 113,154
Net income per share			
Basic	\$ 0.54	\$ 1.17	\$ 1.82
Diluted	\$ 0.54	\$ 1.17	\$ 1.81
Common shares outstanding at period end	64,694	64,502	64,274

(1) See Non-GAAP Financial Measures for a description of Operating EBITDA and Operating EBITDA margin, their limitations and why we consider them to be useful measures. The following table provides a reconciliation of net income to operating income and Operating EBITDA for the periods indicated:

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Net income	\$ 34,943	\$ 75,502	\$ 113,154
Net income attributable to noncontrolling interest	-	-	7,812
Income tax provision (benefit)	24,521	29,449	(16,774)
Interest expense	51,575	53,891	67,516

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Foreign exchange loss on intercompany debt	1,140	5,306	4,777
(Gain) loss on derivative instruments	241	935	(11,501)
Other expenses (income)	1,323	601	(3,186)
Operating income	113,743	165,684	161,798
Add: Depreciation and amortization	71,984	68,333	78,012
Operating EBITDA	\$ 185,727	\$ 234,017	\$ 239,810

**Table of Contents****Selected Production, Sales and Other Data**

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Pulp production ( '000 ADMTs)	1,428.4	1,458.0	1,485.0
Annual maintenance downtime ( '000 ADMTs)	61.4	58.4	31.6
Annual maintenance downtime (days)	43	40	24
Pulp sales ( '000 ADMTs)	1,428.7	1,463.1	1,486.4
Average NBSK pulp list prices in Europe (\$/ADMT) <sup>(1)</sup>	803	850	928
Average NBSK pulp list prices in China (\$/ADMT) <sup>(1)</sup>	599	643	733
Average NBSK pulp list prices in North America (\$/ADMT) <sup>(1)</sup>	978	972	1,025
Average pulp sales realizations (\$/ADMT) <sup>(2)</sup>	586	640	715
Energy production ( '000 MWh)	1,812.6	1,846.8	1,853.5
Energy sales ( '000 MWh)	785.8	815.0	807.8
Average energy sales realizations (\$/MWh)	91	92	110
<b>Average Spot Currency Exchange Rates</b>			
\$ / <sup>(3)</sup>	1.1072	1.1096	1.3297
\$ / C\$ <sup>(3)</sup>	0.7558	0.7830	0.9060

(1) Source: RISI pricing report.

(2) Sales realizations after customer discounts, rebates and other selling concessions. Incorporates the effect of pulp price variations occurring between the order and shipment dates.

(3) Average Noon Buying Rates over the reporting period.

**Year Ended December 31, 2016 Compared to Year Ended December 31, 2015**

Total revenues in 2016 decreased by approximately 10% to \$931.6 million from \$1,033.2 million in 2015.

Pulp revenues in 2016 decreased by approximately 10% to \$847.3 million from \$946.2 million in 2015, due to lower pulp sales realizations and sales volumes.

Energy and chemical revenues decreased by approximately 3% to \$84.3 million in 2016 from \$87.0 million in 2015, primarily due to lower sales volumes.

Pulp production decreased by approximately 2% to 1,428,384 ADMTs in 2016 from 1,457,973 ADMTs in 2015. In 2016, we had annual maintenance downtime of a total of 43 days (approximately 61,400 ADMTs), 37 days of which were scheduled and six days of which were unscheduled to effect additional work at our Celgar mill. In 2015, we had scheduled annual maintenance downtime of 40 days (approximately 58,400 ADMTs). In 2017, we currently estimate taking an aggregate of 36 days of maintenance downtime at our mills.

We estimate that such maintenance downtime in 2016 adversely impacted our Operating EBITDA by approximately \$38.4 million, comprised of approximately \$29.8 million in direct out-of-pocket expenses and the balance in reduced production. Many of our competitors that report their financial results using International Financial Reporting Standards, referred to as IFRS, capitalize their direct costs of maintenance downtime.



Pulp sales volumes marginally decreased by approximately 2% to 1,428,672 ADMTs in 2016 from 1,463,132 ADMTs in 2015, primarily due to lower production at our Celgar mill due to an extended shut and subsequent slow start up at the mill.

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In 2016, list prices for NBSK pulp declined from 2015, largely as a result of the strong dollar and the impact of weakening hardwood pulp prices on NBSK pricing. Average list prices for NBSK pulp in Europe were approximately \$803 per ADMT, compared to approximately \$850 per ADMT in 2015. Average list prices for NBSK pulp in China and North America were approximately \$599 per ADMT and \$978 per ADMT, respectively, in 2016, compared to approximately \$643 per ADMT and \$972 per ADMT, respectively, in 2015.

Average pulp sales realizations decreased by approximately 8% to \$586 per ADMT in 2016 from approximately \$640 per ADMT in 2015, primarily due to lower list prices.

In 2016, the dollar was flat against the euro and 3% stronger against the Canadian dollar compared to 2015, which had a positive impact on our Canadian dollar denominated costs and expenses. However, this was more than offset by the negative impact of a weaker dollar at year end on our Celgar mill's dollar-denominated cash balances and receivables, resulting in an overall negative impact of approximately \$1.8 million in 2016 compared to 2015.

Costs and expenses in 2016 decreased by approximately 6% to \$817.9 million from \$867.5 million in 2015, primarily due to lower fiber prices, lower sales volumes and the reversal of \$20.8 million in accrued wastewater fees at our German mills.

In 2016, operating depreciation and amortization increased by approximately 5% to \$71.5 million from \$67.8 million in 2015.

Selling, general and administrative expenses decreased by approximately 4% to \$44.5 million in 2016 from \$46.2 million in 2015, due to lower costs associated with our completed NAFTA claim.

Transportation costs decreased to \$68.1 million in 2016 from \$74.4 million in 2015, primarily due to lower pulp shipments to China.

On average, our overall per unit fiber costs in 2016 decreased by approximately 8% from 2015, primarily as a result of a balanced wood market in Germany and the Celgar mill's fiber basket. In 2016, our per unit fiber costs in Germany were 9% lower than in 2015. In 2016, our Celgar mill's per unit fiber costs were approximately 6% lower than in 2015, due to strong sawmilling activity in the Celgar mill's fiber basket. In 2017, we currently expect our overall per unit fiber costs to be generally flat, largely as a result of a continuation of balanced market conditions in both markets.

In 2016, our operating income decreased to \$113.7 million from \$165.7 million in 2015, primarily due to lower pulp sales realizations and sales volumes, partially offset by lower fiber prices and the reversal of wastewater fee accruals at our German mills.

Interest expense in 2016 decreased by approximately 4% to \$51.6 million from \$53.9 million in 2015, primarily due to lower indebtedness.

In 2016, we recorded a derivative loss of \$0.2 million on the mark to market adjustment of the Stendal Interest Rate Swap Contract, compared to a derivative loss of \$0.9 million in 2015.

During 2016, as a result of the strengthening of the dollar versus the euro at the end of 2016, we recorded a non-cash loss on the foreign exchange translation of inter-company debt between Mercer Inc. and its wholly-owned subsidiaries of \$1.1 million, compared to \$5.3 million in 2015.

During 2016, we recorded an income tax expense of \$24.5 million, compared to an income tax expense of \$29.4 million in 2015.

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Our tax rate is affected by recurring items, such as tax rates in foreign jurisdictions and the related amounts of income we earn in such jurisdictions, as well as discrete items that may occur in any given year but are not consistent from year to year. Our effective tax rate for fiscal 2016 was 41%, compared to 28% in 2015. This increase was due to lower income from entities for which we do not recognize deferred tax assets.

We had net income of \$34.9 million, or \$0.54 per basic and diluted share, in 2016. In 2015, net income was \$75.5 million, or \$1.17 per basic and diluted share.

In 2016, Operating EBITDA decreased by 21% to \$185.7 million from \$234.0 million in 2015, primarily as a result of lower pulp sales realizations and sales volumes, only being partially offset by lower fiber prices and the reversal of wastewater fee accruals at our German mills.

### **Year Ended December 31, 2015 Compared to Year Ended December 31, 2014**

Total revenues in 2015 decreased by approximately 12% to \$1,033.2 million from \$1,175.1 million in 2014.

Pulp revenues in 2015 decreased by approximately 12% to \$946.2 million from \$1,073.6 million in 2014, due to lower pulp sales realizations and sales volumes.

Energy and chemical revenues decreased by approximately 14% to \$87.0 million in 2015 from \$101.5 million in 2014, primarily due to the impact of a stronger dollar relative to the euro and Canadian dollar, partially offset by higher sales volumes.

Pulp production marginally decreased by approximately 2% to 1,457,973 ADMTs in 2015 from 1,485,011 ADMTs in 2014. We had an aggregate of 40 days (approximately 58,400 ADMTs) of annual maintenance downtime at our mills in 2015, including \$26.4 million in direct out-of-pocket expenses, compared to 24 days (approximately 31,600 ADMTs) in 2014, including \$19.3 million in direct out-of-pocket expenses. Many of our competitors that report their financial results using IFRS capitalize their direct costs of maintenance downtime.

Pulp sales volumes marginally decreased by approximately 2% to 1,463,132 ADMTs in 2015 from 1,486,356 ADMTs in 2014, primarily due to lower production resulting from higher annual maintenance downtime days in 2015.

Average list prices for NBSK pulp in Europe were approximately \$850 per ADMT in 2015, compared to approximately \$928 per ADMT in 2014. Average list prices for NBSK pulp in North America and China were approximately \$972 per ADMT and \$643 per ADMT, respectively, in 2015, compared to approximately \$1,025 per ADMT and \$733 per ADMT, respectively, in 2014.

Average pulp sales realizations decreased by approximately 10% to \$640 per ADMT in 2015 from approximately \$715 per ADMT in 2014, primarily due to lower list prices resulting from the strength of the dollar.

In 2015, the dollar was 16% and 14% stronger against the euro and Canadian dollar, respectively, compared to 2014.

Costs and expenses in 2015 decreased by approximately 14% to \$867.5 million from \$1,013.3 million in 2014, primarily due to the overall impact on costs of the stronger dollar, partially offset by higher annual maintenance downtime costs.

In 2015, operating depreciation and amortization decreased by approximately 13% to \$67.8 million from \$77.7 million in 2014, due to the impact of a stronger dollar relative to the euro and Canadian dollar.



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Selling, general and administrative expenses decreased marginally to \$46.2 million from \$47.9 million in 2014, due to the stronger dollar.

Transportation costs decreased to \$74.4 million in 2015 from \$88.6 million in 2014, primarily due to the impact of a stronger dollar.

On average, our overall per unit fiber costs in 2015 decreased by approximately 14% from 2014, primarily as a result of the effect of a strong dollar versus the euro and the Canadian dollar on local currency per unit fiber prices. In 2015, in local currency terms, average fiber prices in Germany were marginally lower than in 2014, as a result of a generally balanced wood market. In Canadian dollar terms, average fiber prices for our Celgar mill were approximately 17% higher than in 2014, due to the impact of a stronger dollar, as a portion of our Celgar mill's fiber is sourced in dollars and due to increased demand for chips in our Celgar mill's procurement area from coastal pulp mills.

In 2015, our operating income increased to \$165.7 million from \$161.8 million in 2014, primarily due to the effect of a strong dollar, partially offset by lower pulp sales realizations and higher annual maintenance downtime costs.

Interest expense in 2015 decreased by approximately 20% to \$53.9 million from \$67.5 million in 2014, primarily due to lower indebtedness.

The noncontrolling shareholder's interest in the Stendal mill's net income, which was eliminated in the third quarter of 2014, was \$7.8 million in 2014.

In 2015, we recorded a derivative loss of \$0.9 million on the mark to market adjustment of the Stendal Interest Rate Swap Contract, compared to a non-cash derivative gain of \$11.5 million in 2014.

During 2014, we recorded a net gain on the settlement of debt of \$3.4 million, which reflected a gain of \$31.9 million on our acquisition of all of the shareholder loans of the former noncontrolling shareholder in Stendal, in large part offset by a loss of \$28.5 million on the settlement of debt resulting from the refinancing of our long-term debt.

During 2015, as a result of the strengthening of the dollar versus the euro, we recorded a non-cash loss on the foreign exchange translation of inter-company debt between Mercer Inc. and its wholly-owned subsidiaries of \$5.3 million, compared to \$4.8 million in 2014.

During 2015, we recorded an income tax expense of \$29.4 million, compared to a net income tax benefit of \$16.8 million in 2014, due to the recognition of income tax loss carryforwards. The effective tax rate for 2015 was 28%. In 2014, the effective tax rate was a recovery as a result of the recognition of deferred German tax assets primarily consisting of tax loss carryforwards.

We had net income of \$75.5 million, or \$1.17 per basic and diluted share, in 2015. In 2014, net income was \$113.2 million, or \$1.82 per basic and \$1.81 per diluted share, which included a net income tax benefit of \$16.8 million, a non-cash gain on derivative instruments of \$11.5 million and a net gain on the settlement of debt of \$3.4 million.

In 2015, Operating EBITDA marginally decreased by 2% to \$234.0 million from \$239.8 million in 2014, as the decline in pulp sales realizations, lower energy revenues and higher maintenance costs more than offset the positive effect from the strength of the dollar. In 2015, our Operating EBITDA margin was 23%, compared to 20% in 2014.



**Table of Contents****Sensitivities**

Our earnings are sensitive to, among other things, fluctuations in:

**NBSK Pulp Price.** NBSK pulp is a global commodity that is priced in dollars, whose markets are highly competitive and cyclical in nature. As a result, our earnings are sensitive to NBSK pulp price changes. Based upon our 2016 sales volume (and assuming all other factors remained constant), each \$10.00 per tonne change in NBSK pulp list prices yields a change in Operating EBITDA of approximately \$11.0 million.

**Foreign Exchange.** Our operating costs are primarily in euros for our German mills and Canadian dollars for our Celgar mill and our principal product, NBSK pulp, is quoted in dollars. As a result, our operating costs when translated into dollars will fluctuate with changes in the value of the dollar relative to the euro and Canadian dollar. Our business and operating margins have materially benefited from the current strengthening of the dollar. Based on our 2016 operating costs, each \$0.01 change in the value of the dollar relative to the euro and the Canadian dollar yields a total change in annual operating costs of approximately \$8.0 million.

Our energy and chemical sales are made in local currencies and, as a result, decline in dollar terms when the dollar strengthens. Based on our 2016 energy and chemical revenues, each \$0.01 change in the value of the dollar relative to the euro and the Canadian dollar yields a total change in energy and chemical revenues of approximately \$1.0 million.

The above sensitivity analysis provides only a limited point-in-time view of the NBSK pulp price and foreign exchange rates discussed. The actual impact of the underlying price and rate changes may differ materially from that shown in the sensitivity analysis.

**Seasonal Influences.** We are exposed to fluctuations in quarterly sales volumes and expenses due to seasonal factors. These factors are common in the NBSK pulp industry. We generally have weaker pulp demand in Europe during the summer holiday months and in China in the period relating to its lunar new year. We typically have a seasonal build-up in raw material inventories in the early winter months as our mills build up their fiber supply for the winter when there is reduced availability.

**Liquidity and Capital Resources****Summary of Cash Flows**

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
	<b>(in thousands)</b>		
Net cash from operating activities	\$ 140,782	\$ 159,220	\$ 144,588
Net cash used in investing activities	(44,303)	(49,817)	(38,478)
Net cash used in financing activities	(62,377)	(56,664)	(175,752)
Effect of exchange rate on changes in cash, cash equivalents and restricted cash	(2,065)	(7,338)	(14,628)
Net increase (decrease) in cash, cash equivalents and restricted cash	\$ 32,037	\$ 45,401	\$ (84,270)

**Cash Flows from Operating Activities.** Cash from operations includes:



cash received from customers;

cash paid to employees and suppliers;

cash paid for interest on our debt; and

cash paid or received for taxes.

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We operate in a cyclical industry and our operating cash flows vary accordingly. Our principal operating cash expenditures are for labor, fiber, chemicals and debt service.

Working capital levels fluctuate throughout the year and are affected by maintenance downtime, changing sales patterns, seasonality and the timing of receivables and the payment of payables and expenses. Generally, finished goods inventories are increased prior to scheduled maintenance downtime to maintain sales volume while production is stopped. Our fiber inventories exhibit seasonal swings as we increase pulp log and wood chip inventories to ensure adequate supply of fiber to our mills during the winter months. Changes in sales volume can affect the level of receivables and influence overall working capital levels. We believe our management practices with respect to working capital conform to common business practices.

Cash provided by operating activities in 2016 decreased to \$140.8 million from \$159.2 million in 2015 and \$144.6 million in 2014 due to lower operating income. A decrease in accounts receivable provided cash of \$9.5 million in 2016, compared to an increase in accounts receivable using cash of \$11.3 million in 2015 and \$25.1 million in 2014. A decrease in inventories provided cash of \$6.8 million in 2016, compared to an increase in inventories using cash of \$13.2 million in 2015 and a decrease in inventories providing cash of \$6.4 million in 2014. A decrease in accounts payable and accrued expenses used cash of \$10.3 million in 2016, compared to an increase in accounts payable and accrued expenses providing cash of \$9.7 million in 2015 and a decrease in accounts payable and accrued expenses using cash of \$5.4 million in 2014.

***Cash Flows from Investing Activities.*** Cash from investing activities includes:

acquisitions of property, plant and equipment;

proceeds from the sale of assets; and

purchases and sales of short-term investments.

Investing activities in 2016 used cash of \$44.3 million, primarily related to capital expenditures of \$42.5 million and intangible asset purchases of \$1.8 million, primarily related to our ERP project. Investing activities in 2015 used cash of \$49.8 million, primarily related to capital expenditures of \$46.5 million and intangible asset purchases of \$3.8 million, primarily related to our ERP project. Investing activities in 2014 used cash of \$38.5 million, primarily related to capital expenditures of \$34.6 million and intangible asset purchases of \$4.8 million, primarily related to our ERP project.

In 2016, capital expenditures, which used cash of \$42.5 million, were primarily related to a railcar acceptance system for logs and a lime kiln retrofit at our Rosenthal mill, a wastewater reduction project consisting of an evaporation plant upgrade and a project to reduce chloride levels in the process water at our Stendal Mill and new wood harvesting equipment, a logistics and reload center and other maintenance projects at our Celgar mill. In 2015, capital expenditures, which used cash of \$46.5 million, were primarily related to wastewater reduction projects at our German mills designed to reduce wastewater fees that would otherwise be payable and the completion of an automated chip storage project at the Rosenthal mill. In 2014, capital expenditures, which used cash of \$34.6 million, were primarily related to a new chip screening project and a logistics and reload center at our Celgar mill and the automated chip storage project and a new tall oil plant at our Rosenthal mill.



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**Cash Flows from Financing Activities.** Cash from financing activities includes:

issuance and payments of debt;

borrowings and payments under revolving lines of credit;

proceeds from issuances of stock; and

payment of cash dividends and repurchases of stock.

In 2016, financing activities used cash of \$62.4 million, primarily due to our quarterly dividend payments which used cash of \$29.7 million, the repurchase and cancellation of \$23.0 million of our 2019 Senior Notes, which used cash of \$23.1 million, and scheduled payments in respect of the Stendal Interest Rate Swap Contract, which used cash of \$10.9 million. In 2015, financing activities used cash of \$56.7 million, primarily due to repayments of our revolving credit facilities, which used cash of \$23.1 million, the redemption of the payment-in-kind note issued in respect of the purchase of the minority interest in our Stendal mill in 2014, which used cash of \$10.8 million, scheduled payments in respect of the Stendal Interest Rate Swap Contract, which used cash of approximately \$13.5 million, and our quarterly dividend payment, which used cash of \$7.4 million. In 2014, financing activities used cash of \$175.8 million, primarily due to the repurchase of \$334.4 million of our senior notes due 2017 and the payout and discharge of the Stendal mill's then credit facility, which used cash of approximately \$891.0 million, and the payment of \$20.2 million in associated costs, partially offset by the issuance of shares of our common stock, which provided cash of approximately \$53.9 million, the issuance of our 2019 and 2022 Senior Notes, which provided cash of \$650.0 million and borrowings on our revolving credit facilities, which provided cash of \$26.3 million. In 2014, we received \$6.7 million in government grants.

**Balance Sheet Data**

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

<b>Financial Position</b>	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
	<b>(in thousands)</b>	
Cash and cash equivalents	\$ 136,569	\$ 99,629
Working capital	\$ 308,681	\$ 284,390
Total assets	\$ 1,158,708	\$ 1,182,817
Long-term liabilities	\$ 686,410	\$ 695,420
Total equity	\$ 379,128	\$ 382,976

At the end of 2016, as a result of the strengthening of the dollar versus the euro, we recorded a non-cash reduction in the carrying value of our net assets, consisting primarily of our fixed assets, denominated in euros. This non-cash reduction of approximately \$14.4 million does not affect our net income, Operating EBITDA or cash flows but is reflected in our other comprehensive income (loss) and as a reduction to our total equity.



**Table of Contents****Sources and Uses of Funds**

Our principal sources of funds are cash flows from operations and cash and cash equivalents on hand. Our principal uses of funds consist of operating expenditures, capital expenditures and interest payments on our currently outstanding 2019 and 2022 Senior Notes.

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

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
	<b>(in thousands)</b>		
Capital expenditures	\$ 42,526	\$ 46,536	\$ 34,612
Cash paid for interest expense <sup>(1)</sup>	\$ 50,159	\$ 51,975	\$ 65,013
Interest expense <sup>(2)</sup>	\$ 51,575	\$ 53,891	\$ 67,516

(1) Amounts differ from interest expense which includes non-cash items. See supplemental disclosure of cash flow information from our consolidated financial statements included in this annual report.

(2) Interest on our 2019 Senior Notes and our 2022 Senior Notes is paid semi-annually in June and December of each year. In January 2017, we announced the redemption of our 2019 Senior Notes, effective March 1, 2017. See [Business Description of Certain Indebtedness](#) for further information.

As at December 31, 2016, our cash and cash equivalents were \$136.6 million, compared to cash and cash equivalents of \$99.6 million at the end of 2015. As at the end of 2016, we also had cash of \$4.3 million held by Stendal used to secure the Stendal Interest Rate Swap Contract.

As at December 31, 2016, we had approximately \$132.7 million available under our revolving credit facilities.

As at December 31, 2016, we had no material commitments to acquire assets or operating businesses.

In 2017, excluding amounts being financed through government grants, we currently expect capital expenditures to be approximately \$48.0 million.

We currently consider the majority of undistributed earnings of our foreign subsidiaries to be indefinitely reinvested and accordingly no U.S. income tax has been provided on such earnings. However, if we were required to repatriate funds to the United States, we believe that we currently could repatriate the majority thereof without incurring any material amount of taxes as a result of our shareholder advances and tax loss carryforwards. However, it is currently not practical to estimate the income tax liability that might be incurred if such earnings were remitted to the United States.

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

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

**Table of Contents****Credit Facilities and Debt Covenants**

We had the following principal amounts outstanding under our credit facilities, 2019 Senior Notes and 2022 Senior Notes as at the dates indicated:

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
	<b>(in thousands)</b>	
Stendal Revolving Credit Facility	\$ -	\$ -
Rosenthal Loan Facility	\$ -	\$ -
Rosenthal revolving 5.0 million facility	\$ -	\$ -
Celgar Working Capital Facility	\$ -	\$ -
2019 Senior Notes <sup>(1)</sup>	\$ 227,000	\$ 250,000
2022 Senior Notes	\$ 400,000	\$ 400,000

(1) In January 2017, we announced the redemption of our 2019 Senior Notes, effective March 1, 2017. See Item I. Business Description of Certain Indebtedness for further information.

For a description of such indebtedness, see Item 1. Business - Description of Certain Indebtedness .

Certain of our long-term obligations contain various financial tests and covenants customary to these types of arrangements.

Under the Stendal Revolving Credit Facility, our Stendal mill must not exceed a ratio of net debt to EBITDA of 2.5:1 in any 12-month period and there must be a ratio of EBITDA to interest expense equal to or in excess of 1.2:1 for each 12-month period. Additionally, current assets to current liabilities must equal or exceed 1.1:1.

Under the Rosenthal Loan Facility, our Rosenthal mill must not exceed a ratio of net debt to EBITDA of 3:1 in any 12-month period and there must be a ratio of EBITDA to interest expense equal to or in excess of 1.2:1 for each 12 month period. Additionally, current assets to current liabilities must equal or exceed 1.1:1.

The Celgar Working Capital Facility includes a covenant that, for so long as the excess amount under the facility is less than C\$5.0 million, then until it becomes equal to or greater than such amount, the Celgar mill must maintain a fixed charge coverage ratio of not less than 1.1:1 for each 12-month period.

The Stendal Revolving Credit Facility is provided by a syndicate of four financial institutions and our Celgar Working Capital Facility and our Rosenthal facilities are each provided by one financial institution. To date we have not experienced any reductions in credit availability with respect to these credit facilities. However, if any of these financial institutions were to default on their commitment to fund, we could be adversely affected.

The indentures governing the 2019 and 2022 Senior Notes do not contain any financial maintenance covenants and there are no scheduled principal payments until maturity. Interest on our 2019 Senior Notes is payable semi-annually in arrears on June 1 and December 1, commencing June 1, 2015, at the rate of 7.000% and they mature in December 2019. Interest on our 2022 Senior Notes is payable semi-annually in arrears on June 1 and December 1, commencing June 1, 2015, at the rate of 7.750% and they mature in December 2022.



As at December 31, 2016, we were in full compliance with all of the covenants of our indebtedness.

**Table of Contents****Off-Balance-Sheet Activities**

At December 31, 2016 and 2015, we had no off-balance sheet arrangements.

**Contractual Obligations and Commitments**

The following table sets out our contractual obligations and commitments as at December 31, 2016:

Contractual Obligations <sup>(1)</sup>	Payments Due By Period				Total
	2017	2018-2019	2020-2021	Beyond 2021	
	(in thousands)				
Debt <sup>(2)</sup>	\$ -	\$ 227,000 <sup>(3)</sup>	\$ -	\$ 400,000 <sup>(3)</sup>	\$ 627,000
Interest rate derivative	6,522	-	-	-	6,522
Interest on debt <sup>(4)</sup>	48,141	94,694	62,000	28,417	233,252
Capital lease obligations <sup>(5)</sup>	3,908	7,490	3,867	12,208	27,473
Operating lease obligations <sup>(6)</sup>	1,666	2,616	1,102	-	5,384
Purchase obligations <sup>(7)</sup>	4,996	3,186	361	-	8,543
Other long-term liabilities <sup>(8)</sup>	3,949	6,343	6,474	16,843	33,609
Total	\$ 69,182	\$ 341,329	\$ 73,804	\$ 457,468	\$ 941,783

- (1) We have identified approximately \$4.7 million of asset retirement obligations. However, due to the uncertain timing related to these potential liabilities, we are unable to allocate the payments in the contractual obligations table.
- (2) This reflects the future principal payments due under our long-term debt obligations. See Item 1. Business - Description of Certain Indebtedness and Note 6 to our consolidated financial statements included herein for a description of such indebtedness.
- (3) In January 2017, we announced the redemption of our 2019 Senior Notes, effective March 1, 2017, and the issuance of \$225.0 million in aggregate principal amount of our 2024 Senior Notes. See Item 1. Business - Description of Certain Indebtedness for further information.
- (4) Amounts presented for interest payments assume that all debt outstanding as of December 31, 2016 will remain outstanding until maturity, and interest rates on variable rate debt in effect as of December 31, 2016 will remain in effect until maturity.
- (5) Capital lease obligations relate to transportation vehicles and production equipment. These amounts reflect principal and imputed interest.
- (6) Operating lease obligations relate to transportation vehicles and other production and office equipment.
- (7) Purchase obligations relate primarily to take-or-pay contracts, including for purchases of raw materials, made in the ordinary course of business.
- (8) Other long-term liabilities relate primarily to future payments that will be made for post-employment benefits. Those amounts are estimated using actuarial assumptions, including expected future service, to project the future obligations. Additionally, the balance also includes pension funding which is calculated on an annual basis. Consequently, the 2017 amount includes \$0.9 million related to pension funding.

**Foreign Currency**

Our reporting currency is the dollar. However, we hold certain assets and liabilities in euros and Canadian dollars and the majority of our expenditures are denominated in euros or Canadian dollars. Accordingly, our consolidated financial results are subject to foreign currency exchange rate fluctuations.

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

In the year ended December 31, 2016, we reported a net \$14.4 million foreign currency translation loss and, as a result, the cumulative foreign exchange translation loss reported within accumulated other comprehensive loss increased to \$170.6 million as at December 31, 2016. In the year ended December 31, 2015, we reported a net \$123.0 million foreign currency translation loss.

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Based upon the exchange rate at December 31, 2016, the dollar increased by approximately 3% in value against the euro and decreased by approximately 3% in value against the Canadian dollar since December 31, 2015. See Item 7A. Quantitative and Qualitative Disclosures about Market Risk .

### **Credit Ratings of 2019, 2022 and 2024 Senior Notes**

We and our 2019 and 2022 Senior Notes are rated by Standard & Poor's Rating Services, referred to as S&P , and Moody's Investors Service, Inc., referred to as Moody's . On October 14, 2016, Moody's upgraded its current rating on our 2019 and 2022 Senior Notes to B1 from B2 and upgraded our corporate family rating to Ba3 from B1, maintaining its outlook as stable . On October 20, 2016, S&P upgraded its current rating on our 2019 and 2022 Senior Notes to BB- from B+ and upgraded our long-term corporate credit rating to BB- from B+, maintaining its outlook as stable .

S&P and Moody's base their assessment of the credit risk on our 2019 and 2022 Senior Notes on the business and financial profile of Mercer Inc. and our restricted subsidiaries under the indentures governing the 2019 and 2022 Senior Notes. As of December 31, 2016, all of our subsidiaries are restricted subsidiaries. Factors that may affect our credit rating include changes in our operating performance and liquidity. Credit rating downgrades can adversely impact, among other things, future borrowing costs and access to capital markets.

Credit ratings are not recommendations to buy, sell or hold securities and may be subject to revision or withdrawal by the assigning rating organization. Each rating should be evaluated independently of any other rating.

In January 2017, we announced the redemption of all of our outstanding 2019 Senior Notes and the issuance of \$225.0 million aggregate principal amount of 2024 Senior Notes. Moody's rating on the 2024 Senior Notes is B1 and its outlook is stable and S&P's rating on the 2024 Senior Notes is BB- and its recovery rating is 3 .

### **Critical Accounting Policies**

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

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

The following accounting policies require management's most difficult, subjective and complex judgments, and are subject to a fair degree of measurement uncertainty.



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***Pension and Other Post-Retirement Benefit Obligations***

We maintain a defined benefit pension plan and other post-retirement benefit plan for certain employees at our Celgar mill which is funded based on actuarial estimates and requirements and are non-contributory. We recognize the net funded status of the plan and we record net periodic benefit costs associated with these net obligations. As at December 31, 2016, we had pension and other post-retirement benefit obligations aggregating \$59.1 million and accumulated pension plan assets with a fair value of \$33.0 million. Our 2016 net periodic pension and other post-retirement benefit costs were \$2.0 million. The amounts recorded for the net pension and other post-retirement obligations include various judgments and uncertainties.

The following inputs are used to determine our net obligations and our net periodic benefit costs each year and the determination of these inputs requires judgment:

discount rate used to determine the net present value of our pension and other post-retirement benefit obligations and to determine the interest cost component of our net periodic pension and other post-retirement benefit costs;

return on assets used to estimate the growth in the value of invested assets that are available to satisfy pension obligations and to determine the expected return on plan assets component of our net periodic pension costs;

mortality rate used to estimate the impact of mortality on pension and other post-retirement benefit obligations;

rate of compensation increase used to calculate the impact future pay increases will have on pension benefit obligations; and

health care cost trend rate used to calculate the impact of future health care costs on other post-retirement benefit obligations.

For the discount rate, we use the rates available on high-quality corporate bonds with a duration that is expected to match the timing of expected pension and other post-retirement benefit obligations. High-quality corporate bonds are those with a rating of AA or better.

In determining the expected return on assets, we consider the historical long-term returns, expected asset mix and the active management premium.

For the mortality rate we use actuarially-determined mortality tables that are consistent with our historical mortality experience and future expectations for mortality of the employees who participate in our pension and other post-retirement benefit plans.

In determining the rate of compensation increase, we review historical compensation increases and promotions, while considering current industry conditions, the terms of collective bargaining agreements with employees and the outlook

for the industry.

For the health care cost trend rate, we consider historical trends for these costs, as well as recently enacted healthcare legislation. We also compare our health care rate to those of our industry.

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Variations in assumptions described above could have a significant effect on the pension and other post-retirement benefit net periodic benefit cost and obligation reported in our consolidated financial statements. For example, a one-percentage point change in any one of the following assumptions would have increased (decreased) our 2016 net periodic benefit cost and our accrued benefit obligation as follows:

<b>Assumption</b>	<b>Net periodic benefit cost</b>		<b>Accrued benefit obligation</b>	
	<b>1% increase</b>	<b>1% decrease</b>	<b>1% increase</b>	<b>1% decrease</b>
	<b>(\$ in thousands)</b>			
Discount rate	112	(185)	(7,077)	8,102
Return on assets	(294)	294	N/A	N/A
Rate of compensation	15	(15)	359	(355)
Health care cost trend rate	32	(34)	578	(564)

**Deferred Taxes**

As at December 31, 2016, we had \$11.0 million in deferred tax assets and \$17.3 million in deferred tax liabilities, resulting in a net deferred tax liability of \$6.3 million. Our tax assets are net of an \$81.4 million valuation allowance. Our deferred tax assets 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 at each reporting period to determine whether it is more likely than not that the deferred tax assets will be realized. Our assessment includes a review of all available positive and negative evidence, including, but not limited to, the following:

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

future reversals of temporary differences;

our historical and projected earnings; and

tax planning opportunities.

Significant judgment is required when evaluating the positive and negative evidence, specifically the Company's estimates of future earnings. The weight given to negative and positive evidence is commensurate with the extent to which it can be objectively verified. Operating results during the most recent three-year period are generally given more weight than expectations of future profitability, which are inherently uncertain. A cumulative loss position during the most recent three-year period is considered significant negative evidence in assessing the realizability of deferred income tax assets that is difficult to overcome.

Once our evaluation of the evidence is complete, if we believe that it is more likely than not that some of the deferred tax assets will not be realized, based on currently available information, an income tax valuation allowance is recorded against the deferred tax assets.



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

***Property, Plant and Equipment***

As at December 31, 2016, we had property, plant and equipment recorded in our Consolidated Balance Sheet of \$738.3 million. In 2016, we recorded depreciation and amortization for property, plant and equipment of \$69.1 million.

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The calculation of depreciation and amortization of property, plant and equipment requires us to apply judgment in selecting the remaining useful lives of the assets. The remaining useful life of an asset must address both physical and economic considerations. The remaining economic life of property, plant and equipment may be shorter than its physical life. The pulp industry in recent years has been characterized by considerable uncertainty in business conditions. Estimates of future economic conditions for our property, plant and equipment and therefore, their remaining useful economic life, require considerable judgment.

If our estimate of the remaining useful life changes, such a change is accounted for prospectively in our determination of depreciation and amortization. Actual depreciation and amortization charges for an individual asset may therefore be significantly accelerated if the outlook for its remaining useful life is shortened considerably.

We evaluate property, plant and equipment for impairment whenever events or changes in circumstances indicate that the carrying value 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 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 property, plant and equipment 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. If actual results are not consistent with the assumptions and judgments used in estimating future cash flows and asset fair values, actual impairment losses could vary materially, either positively or negatively, from estimated impairment losses.

## ***Contingent Liabilities***

We are subject to lawsuits, investigations and other claims related to environmental, product and other matters, and are required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. We disclose contingent liabilities when there is a reasonable possibility that an ultimate loss may occur and we record contingent liabilities when it becomes probable that we will have to make payments and the amount of loss can be reasonably estimated.

Assessing probability of loss and estimating probable losses requires analysis of multiple factors, including, but not limited to, the following:

historical experience;

judgments about the potential actions of third party claimants and courts; and

recommendations of legal counsel.

Contingent liabilities are based on the best information available and actual losses in any future period are inherently uncertain. If estimated probable future losses or actual losses exceed our recorded liability for such claims, we would record additional charges. These exposures and proceedings can be significant and the ultimate negative outcomes could be material to our operating results or liquidity in any given quarter or year.

## **New Accounting Standards**

See Note 1 to our consolidated financial statements included in Item 15 of this annual report on Form 10-K.

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**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risks from changes in interest rates and foreign currency exchange rates, particularly the exchange rates between the dollar and the euro and Canadian dollar. Changes in these rates may affect our results of operations and financial condition and, consequently, our fair value. We seek to manage these risks through internal risk management policies as well as the periodic use of derivatives. We may use derivatives to reduce or limit our exposure to interest rate and currency risks. We may also use derivatives to reduce or limit our exposure to fluctuations in pulp prices. We 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 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 is not effective, we may incur significant 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 periodically use are interest rate derivatives, pulp price derivatives, energy derivatives and foreign exchange derivatives.

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. 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.

Pulp price derivatives include fixed price pulp swaps which are contracts in which two counterparties exchange payments based upon the difference between the market price of pulp and the notional amount in the contract.

Energy derivatives include fixed electricity forward sales and purchase contracts which are contractual obligations to buy or sell electricity at a future specified date. Our mills produce surplus electricity that we sell to third parties. As a result, we monitor the electricity market closely. Where possible and to the extent we think it is advantageous, we may sell into the forward market through forward contracts.

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.

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As at December 31, 2016 and 2015, we had no outstanding derivatives, other than the Stendal Interest Rate Swap Contract.

However, in the future, we may from time to time use foreign exchange derivatives to convert some of our costs (including currency swaps relating to our long-term indebtedness) from euros to dollars as our principal product is priced in dollars. We have also converted some of our costs to dollars by issuing long-term dollar-denominated debt in the form of our 2019 Senior Notes, 2022 Senior Notes and, commencing in February 2017, 2024 Senior Notes. We may also from time to time use pulp price derivatives to fix price realizations and interest rate derivatives to fix the rate of interest on indebtedness.

In August 2002, Stendal entered into the Stendal Interest Rate Swap Contract in connection with its long-term indebtedness relating to the Stendal mill to fix the interest rate thereunder at the then low level, relative to its historical trend and projected variable interest rate. Under the Stendal Interest Rate Swap Contract, Stendal pays a fixed rate and receives a floating rate with the interest payments being calculated on a notional amount. The interest rates payable thereunder were swapped into fixed rates based on the Euribor rate for the repayment periods of the tranches under Stendal's indebtedness. Stendal effectively converted its indebtedness from a variable interest rate loan into a fixed interest rate loan. The Stendal Interest Rate Swap Contract was left in place following the refinancing of Stendal's indebtedness in November 2014.

We record unrealized gains and losses on our outstanding derivatives when they are marked to market at the end of each reporting period and realized gains or losses on them when they are settled. We determine market valuations based primarily upon valuations provided by our counterparties.

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 and large utilities, will fail to meet their obligations.

The following table and the notes thereto sets forth the maturity date, the notional amount, the recognized gain or loss and the strike and swap rates for derivatives that were in effect during 2016 and 2015:

Derivative Instrument	Maturity Date	December 31, 2016		December 31, 2015	
		Notional Amount (in millions)	Recognized Gain (Loss) (in thousands)	Notional Amount (in millions)	Recognized Gain (Loss) (in thousands)
Stendal interest rate swap <sup>(1)</sup>	October 2017	\$ 135.4	\$ (241)	\$ 209.0	\$ (935)

(1) In 2002, Stendal entered into the Stendal Interest Rate Swap Contract with respect to an aggregate maximum amount of approximately 612.6 million of the principal amount of the long-term indebtedness under its then credit facility. The remaining contract commenced 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 in October 2017.

**Interest Rate Risk**

Fluctuations in interest rates may affect the fair value of fixed interest rate financial instruments which are sensitive to such fluctuations. A decrease in interest rates may increase the fair value of such fixed interest rate financial instrument assets and an increase in interest rates may decrease the fair value of such fixed interest rate financial

instrument liabilities, thereby increasing our fair value. An increase in interest rates may decrease the fair value of such fixed interest rate financial instrument assets and a decrease in interest rates may increase the fair value of such fixed interest rate financial instrument liabilities, thereby decreasing our fair value. We may seek to manage our interest rate risks through the use of interest rate derivatives. For a discussion of our interest rate derivatives including maturities, notional amounts, gains or losses and swap rates, see - Derivatives .

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The following tables provide information about our exposure to interest rate fluctuations for the financial instruments sensitive to such fluctuations as at December 31, 2016 and expected cash flows from these instruments:

	Total	Fair Value	As at December 31, 2016					Thereafter
			2017	2018	2019	2020	2021	
(in thousands, other than percentages)								
<b>Liabilities</b>								
Long-term debt:								
Fixed rate (\$) <sup>(1)(2)</sup>	627,000	654,378	-	-	227,000	-	-	400,000
Average interest rate	7.47%	7.47%						
	Notional Amount	Fair Value	2017	2018	2019	2020	2021	Thereafter
(in thousands, other than percentages)								
<b>Interest Rate Derivative</b>								
<b>Liability</b>								
Interest rate swap:								
Variable to fixed								
(\$) <sup>(3)</sup>	135,432	6,522	135,432	-	-	-	-	-
Average pay rate	5.28%	5.28%	5.28%	-	-	-	-	-
Average receive rate	(0.20)%	(0.20)%	(0.20)%	-	-	-	-	-

(1) 2019 Senior Notes bearing interest at 7.0%, principal amount \$227.0 million. In January 2017, we announced the redemption of our 2019 Senior Notes, effective March 1, 2017. See Item 1. Business Description of Certain Indebtedness for further information.

(2) 2022 Senior Notes bearing interest at 7.75%, principal amount \$400.0 million.

(3) The Stendal Interest Rate Swap Contract.

**Foreign Currency Exchange Rate Risk**

Our reporting currency is the dollar. However, we hold financial instruments denominated in euros and Canadian dollars which are sensitive to foreign currency exchange rate fluctuations. A depreciation of these currencies against the dollar will decrease the fair value of such financial instrument assets and an appreciation of these currencies against the dollar will increase the fair value of such financial instrument liabilities, thereby decreasing our fair value. An appreciation of these currencies against the dollar will increase the fair value of such financial instrument assets and a depreciation of these currencies against the dollar will decrease the fair value of financial instrument liabilities, thereby increasing our fair value. We may seek to manage our foreign currency risks by utilizing foreign exchange rate derivatives. For a discussion of such derivatives including maturities, notional amounts, gains or losses and strike rates, see Derivatives .



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The following table provides information about our exposure to foreign currency exchange rate fluctuations for the carrying amount of financial instruments sensitive to such fluctuations as at December 31, 2016 and expected cash flows from these instruments:

Financial Instruments	Carrying Value	Fair Value	As at December 31, 2016					Thereafter
			Expected maturity date					
			2017	2018	2019	2020	2021	
<b>in euros</b>								
Cash and cash equivalents	63,078	63,078	63,078	-	-	-	-	-
Restricted cash	4,100	4,100	4,100	-	-	-	-	-
Accounts receivable	53,847	53,847	53,847	-	-	-	-	-
Accounts payable and accrued liabilities	44,665	44,665	44,665	-	-	-	-	-
Derivative financial instruments	6,180	6,180	6,180	-	-	-	-	-
Capital leases	20,502	20,502	2,931	2,428	3,113	1,341	1,270	9,419
<b>in Canadian dollars</b>								
Cash and cash equivalents	11,728	11,728	11,728	-	-	-	-	-
Accounts receivable	4,166	4,166	4,166	-	-	-	-	-
Accounts payable and accrued liabilities	29,113	29,113	29,113	-	-	-	-	-
Capital leases	1,393	1,393	276	276	276	276	276	13

**Pulp Price Risk**

Fluctuations in the price of pulp will affect the fair value of pulp price swaps. A decrease in pulp prices will increase the fair value of the pulp price swaps and an increase in pulp prices will decrease the fair value of the pulp price swaps.

**Energy Price Risk**

We are subject to some energy price risk, primarily for natural gas purchases. Our electricity price risks are mitigated by the ability of all of our mills to produce renewable energy.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The consolidated financial statements and supplementary data required with respect to this Item 8, and as listed in Item 15 of this annual report on Form 10-K, are included in this annual report on Form 10-K commencing on page 88.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

Not applicable.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of the end of the period covered by this annual

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report on Form 10-K. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Based on such evaluation, our principal executive officer and principal financial officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act.

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

## **Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Mercer's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Our internal control over financial reporting includes those policies and procedures that:

Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Mercer;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree or compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of Mercer's internal control over financial reporting as of December 31, 2016. In making this assessment, management used the criteria set forth in *Internal Control-Integrated Framework*, as issued in 2013 by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment and those criteria, management concluded that Mercer maintained effective internal control over financial reporting as of December 31, 2016.

The effectiveness of Mercer's internal control over financial reporting as of December 31, 2016 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their attestation report which appears within.

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**Changes in Internal Controls**

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

**ITEM 9B. OTHER INFORMATION**

Not applicable.

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**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

**Executive Chairman, Chief Executive Officer and Directors**

We are governed by a board of directors, referred to as the Board, each member of which is elected annually. The following sets forth information relating to our directors and executive officers.

*Jimmy S.H. Lee*, age 59, has served as director since May 1985, as President and Chief Executive Officer from 1992 to July 2015 and as Executive Chairman since July 2015. In March 2016, Mr. Lee was appointed a director of Golden Valley Mines Ltd. Previously, during the period when MFC Bancorp Ltd. was our affiliate, he served as a director from 1986 and President from 1988 to December 1996 when it was spun out. Mr. Lee was also a director of Quinsam Capital Corp. from March 2004 to November 2007 and Fortress Paper Ltd. from August 2006 to April 2008. During Mr. Lee's tenure with Mercer, we acquired the Rosenthal mill and converted it to the production of kraft pulp, constructed and commenced operations at the Stendal mill and acquired the Celgar mill. He holds a Bachelor of Science degree in Chemical Engineering from the University of British Columbia, Canada. Mr. Lee possesses particular knowledge and experience in our business as a founder and as our Chief Executive Officer for over 24 years. He also has broad knowledge and experience in finance and banking, credit markets, international pulp markets, derivative risk management and capital allocation. Through his experience and background, Mr. Lee provides vision and leadership to the Board. Mr. Lee also provides the Board with insight and information regarding our strategy, operations and business.

*David M. Gandossi*, age 59, has served as a director and as Chief Executive Officer and President since July 2015 and served as Executive Vice-President, Chief Financial Officer and Secretary from August 2003 to July 2015. His previous roles included Chief Financial Officer and other senior executive positions with Formation Forest Products and Pacifica Papers Inc. Since 2007, Mr. Gandossi has chaired the B.C. Pulp and Paper Task Force, a joint government industry and labor effort mandated to identify measures to improve the competitiveness of the British Columbia pulp and paper industry. He also participated in the Pulp and Paper Advisory Committee to the BC Competition Council and was a member of B.C.'s Working Roundtable on Forestry. He is currently a director of FPInnovations and Chair of the FPI National Research Advisory Committee. He also co-chairs the BC Bio-economy Transformation Council, a collaborative effort between Government and industry. Mr. Gandossi holds a Bachelor of Commerce degree from the University of British Columbia and is a Fellow of the Institute of Chartered Accountants of British Columbia in Canada.

*Eric Lauritzen*, age 78, has served as a director since June 2004. From 1994 until his retirement in 1998, he was President and Chief Executive Officer of Harmac Pacific, Inc., a TSX-listed pulp producer that was acquired by Pope & Talbot Inc. From 1981 to 1994, he served as Vice President, Pulp and Paper Marketing of MacMillan Bloedel Limited, a TSX-listed North American pulp and paper company that was acquired by Weyerhaeuser Company Limited. Mr. Lauritzen has accumulated extensive executive, production and marketing experience in the pulp and paper industry, particularly in the softwood kraft pulp sector. He received his Bachelor of Commerce degree in 1961 from the University of British Columbia and his M.B.A. in 1963 from Harvard Business School. Mr. Lauritzen brings to the Board broad industry and leadership experience and understanding of the pulp business on a global basis, including sales and marketing. He also provides leadership to our Board on board practices, governance matters and succession planning in his role as the Lead Director of the Board.

*William D. McCartney*, age 61, has served as a director since January 2003. He has been the President and Chief Executive Officer of Pemcorp Management Inc., a corporate finance and management consulting firm, since its inception in 1990. From 1984 to 1990, he was a founding partner of Davidson &

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Company, Chartered Accountants, where he specialized in business advisory services. He has been involved with numerous capital restructuring and financing events involving several public companies and brings substantial knowledge relating to the financial accounting and auditing processes. He is a member of the Local Advisory Committee of the TSX and TSX Venture Exchange. He is a chartered accountant and has been a member of the Canadian Institute of Chartered Accountants since 1980. He holds a Bachelor of Arts degree in Business Administration from Simon Fraser University. Mr. McCartney has extensive experience in accounting, financial and capital markets. He provides the Board with insight and leads its review and understanding of accounting, financial and reporting matters. Mr. McCartney provides the Board experience and leadership on accounting and financial matters in his role as Chair of the Board's Audit Committee.

*Graeme A. Witts*, age 78, has served as a director since 2003. He is also a director and the former Chairman of Azure Property Group, SA, a European hotel group. He organized Sanne Trust Company Limited, a trust company located in the Channel Islands, in 1988 and was Managing Director from 1988 to 2000, when he retired. Mr. Witts has previous executive experience with the Procter & Gamble Company, as well as with Clarks shoes. He also has experience in government auditing and brings significant financial accounting knowledge from a global perspective. Mr. Witts is a Fellow of the Institute of Chartered Accountants of England and Wales and holds a masters degree in chemistry from Oxford University and a research degree in magnetic resonance. Mr. Witts has extensive experience in global accounting and financial matters, which he brings to the Board along with senior executive experience with large international companies. His broad knowledge and senior level experience in European businesses, accounting and financing matters provide valuable insights to the Board.

*Bernard Picchi*, age 67, has served as a director since June 2011. He is now Managing Director of Private Wealth Management for Palisade Capital Management, LLC, of Fort Lee, New Jersey, and has been in that role since July 2009. Before joining Palisade, Mr. Picchi served as Managing Partner of Willow Rock Associates from August 2008 through June 2009, a company which advised securities firms on energy investments. From March 2003 through July 2008, Mr. Picchi served as Senior Energy Analyst at two independent research firms based in New York City, Foresight Research Solutions (2003-2005) and Wall Street Access (2006-2008). From 1999 through 2002, he was Director of U.S. Equity Research at Pittsburgh-based Federated Investors, where he also managed the Capital Appreciation Fund, a 5-star rated (during his tenure) \$1.5 billion equity mutual fund. Before Federated Investors, Mr. Picchi enjoyed a 20-year career on Wall Street (Salomon Brothers, Kidder Peabody, and Lehman Brothers) both as an award-winning energy analyst and as an executive (Director of U.S. Equity Research at Lehman in the mid-1990s). He began his post-college career at Mellon Bank in Pittsburgh, Pennsylvania. Mr. Picchi holds a Bachelor of Science degree in Foreign Service from Georgetown University, and he has achieved the professional designation Chartered Financial Analyst. He has also served on various non-profit boards, most notably that of the Georgetown University Library on which he has served for the past 30 years. Mr. Picchi brings to our Board his significant experience and financial expertise in the capital markets, investments and analysis of public companies. His broad experience in the capital markets and particularly as a financial analyst and wealth manager provide the Board with valuable insight into the expectations, concerns and interests of investors, shareholders and the capital markets generally.

*James Shepherd*, age 64, has served as a director since June 2011. He is also currently a director of Buckman Laboratories International Inc. Mr. Shepherd was President and Chief Executive Officer of Canfor Corporation from 2004 to 2007 and Slocan Forest Products Ltd. from 1999 to 2004. He is also the former President of Crestbrook Forest Industries Ltd. and Finlay Forest Industries Limited and the former Chairman of the Forest Products Association of Canada. Mr. Shepherd has previously served as a director of Conifex Timber Inc., Canfor Corporation and Canfor Pulp Income Fund (now Canfor Pulp Products Inc.). Mr. Shepherd holds a degree in Mechanical Engineering from Queen's University. Mr. Shepherd has held several chief executive officer leadership and other senior positions in the forest industry. As a result,





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Mr. Shepherd brings to the Board extensive senior executive experience relevant to our operations and an understanding of all aspects of the forest products business, ranging from fiber harvesting to lumber and pulp and paper operations. He also brings to our Board significant experience and background in the designing, execution and implementation of large, complex capital projects at large manufacturing facilities like our mills.

*R. Keith Purchase*, age 72, has served as a director since June 2012. Mr. Purchase was Executive Vice-President and Chief Operating Officer for MacMillan Bloedel Ltd. from 1998 to 1999, President and Chief Executive Officer of TimberWest Forest Ltd. from 1994 to 1998 and Managing Director of Tasman Pulp and Paper from 1990 to 1994. Mr. Purchase was previously a director of Catalyst Paper Corporation and Chair of its board of directors. Mr. Purchase has held several very senior positions in significant companies involved in the forestry industry. He brings to the Board extensive senior executive experience relevant to the Company's operations, as well as significant board of director leadership experience from a wide variety of companies.

*Nancy Orr*, age 66, has served as a director since May 2013. Ms. Orr is also a director of Protocol Biomass Corp., Prometic Life Sciences Inc. and Ressources Québec, a subsidiary of Investissement Québec. Ms. Orr's previous experience includes serving as President of Dynamis Group Inc. from 1991 to 2007, a private company involved in the energy and wood recycling sectors in Europe and the United States. Ms. Orr also served as Interim Chief Financial Officer of Redline Communications Inc., where she also served as a director, Chair of its Audit Committee and a member of its Compensation Committee. She brings to the Board significant experience as a senior executive, director and audit and compensation committee member of a wide variety of publicly traded companies and government corporations, including the Bank of Canada, Dundee Wealth Management Inc., Fibrek Inc., Donohue Inc., les Services Financiers CDPQ – la Caisse de dépôt et placement du Québec, H.E.C. Montréal and FRV Media Inc. Ms. Orr is a member of the Women Corporate Directors and a Fellow member of the Chartered Professional Accountants of Quebec and holds a Master of Business Administration from Queen's University and a Bachelor of Arts degree from the University of Western Ontario. Ms. Orr brings to the Board extensive experience and knowledge in the forest products industry and in financial and accounting matters. She provides the Board with valuable experience and insight into board and governance practices and accounting matters.

**Other Executive Officers**

*David K. Ure*, age 49, returned to Mercer in September 2013, assuming the role of Senior Vice President, Finance from September 2013 to July 2015 and the role of Chief Financial Officer and Secretary from July 2015. Prior to serving as Vice President, Finance of Sierra Wireless Inc., Mr. Ure was Vice President, Controller at Mercer from 2006 to 2010. He has also served as Controller at various companies including Catalyst Paper Corp., Pacifica Papers Inc., and Trojan Lithograph Corporation, as well as CFO and Secretary of Finlay Forest Industries Inc. Mr. Ure has over 15 years' experience in the forest products industry. He holds a Bachelor of Commerce in Finance from the University of British Columbia, Canada and is a member of the Certified General Accountants' Association of Canada.

*Leonhard Nossol*, age 59, has served as our Group Controller for Europe since August 2005. He has also been Managing Director of Rosenthal since 1997 and the sole Managing Director of Rosenthal since 2005. Before joining Mercer, Mr. Nossol was Director, Finance and Administration for a German household appliance producer from 1992 to 1997. Prior to this, he was Operations Controller at Grundig AG (consumer electronics) in Nürnberg. Mr. Nossol has been a member of the German Industry Federation's (BDI) Tax Committee since 2003. He was elected President of the German Wood Users Association (AGR) in 2013. Mr. Nossol holds a Political Science degree from Freie Universität Berlin and a degree in Business Management from the University of Applied Sciences in Berlin.



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*Richard Short*, age 49, has served as Vice President, Controller since February 2014 and as Controller from November 2010 to February 2014, prior to which he served as Controller and Director, Corporate Finance since joining Mercer in 2007. Previous roles include Controller, Financial Reporting from 2006 to 2007 and Director, Corporate Finance from 2004 to 2006 with Catalyst Paper Corporation and Assistant Controller at the Alderwoods Group Inc. Mr. Short holds a Bachelor of Arts in Psychology from the University of British Columbia and has been a member of the Canadian Institute of Chartered Accountants since 1993.

*David M. Cooper*, age 63, has served as Vice President of Sales and Marketing for Europe since 2005. Mr. Cooper previously held a variety of senior positions around the world at Sappi Ltd. from 1982 to 2005. These roles included the sales and marketing of various pulp and paper grades and the management of a manufacturing facility. Mr. Cooper has more than thirty years of diversified experience in the international pulp and paper industry.

*Eric X. Heine*, age 53, has served as Vice President of Sales and Marketing for North America and Asia since June 2005. Mr. Heine was previously Vice President Pulp and International Paper Sales and Marketing for Domtar Inc. from 1999 to 2005. Mr. Heine has over twenty-five years of experience in the pulp and paper industry, including developing strategic sales channels and market partners to build corporate brands. He holds a Bachelor of Science in Forestry (Wood Science) from the University of Toronto, Canada.

*Wolfram Ridder*, age 55, has served as Vice President of Business Development since 2005, prior to which he served as Managing Director at Mercer's Stendal mill from 2001 to 2005. Mr. Ridder also served as Vice President Pulp Operations, Assistant to CEO from 1999 to 2005 and Assistant Managing Director at the Rosenthal mill from 1995 to 1998. Prior to joining Mercer, Mr. Ridder worked as a Scientist for pulping technology development at the German Federal Research Center for Wood Science and Technology in Hamburg from 1988 to 1995. Mr. Ridder has a Master of Business Administration and a Master of Wood Science and Forest Product Technology from Hamburg University.

*Genevieve Stannus*, age 46, has served as Treasurer since July 2005, prior to which she served as Senior Financial Analyst since joining Mercer in August 2003. Prior to her role at Mercer, Ms. Stannus held Senior Treasury Analyst positions with Catalyst Paper Corporation and Pacifica Papers Inc. Ms. Stannus has over twenty years of experience in the forest products industry. She is a member of the Certified General Accountants Association of Canada.

*Brian Merwin*, age 43, has served as Vice President, Strategic Initiatives since February 2009. Mr. Merwin previously held roles within Mercer such as Director, Strategic and Business Initiatives, and Business Analyst. He was a key member of the Celgar Energy Project, and was instrumental in the development of the B.C. Hydro energy purchase agreement and securing the ecoENERGY grant. Mr. Merwin has a Master of Business Administration from the Richard Ivey School of Business in Ontario, Canada and a Bachelor of Commerce degree from the University of British Columbia, Canada.

We also have experienced mill managers at all of our mills who have operated through multiple business cycles in the pulp industry.

The Board met six times during 2016 and each current member of the Board attended 100% of the total number of such meetings and meetings of the committees of the Board on which they serve during their term. In addition, our independent directors regularly meet in separate executive sessions without any member of our management present. The Lead Director presides over these meetings. Although we do not have a formal policy with respect to attendance of directors at our annual meetings, all directors are encouraged and expected to attend such meetings if possible. All of our directors attended our 2016 annual meeting.



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The Board has developed corporate governance guidelines in respect of: (i) the duties and responsibilities of the Board, its committees and officers; and (ii) practices with respect to the holding of regular quarterly and strategic meetings of the Board including separate meetings of non-management directors. The Board has established four standing committees, the Audit Committee, the Compensation and Human Resource Committee, the Governance and Nominating Committee and the Environmental, Health and Safety Committee.

### **Audit Committee**

The Audit Committee was established in accordance with Section 3(a)(58)(A) of the Exchange Act and functions pursuant to a charter adopted by the directors. A copy of the current charter is incorporated by reference in the exhibits to this Form 10-K and is available on our website at [www.mercerint.com](http://www.mercerint.com) under the Governance link. The function of the Audit Committee generally is to meet with and review the results of the audit of our financial statements performed by the independent public accountants and to recommend the selection of independent public accountants. The members of the Audit Committee are Mr. McCartney, Mr. Witts and Ms. Orr, each of whom is independent under applicable laws and regulations and the listing requirements of the NASDAQ Global Select Market. Mr. McCartney is a Chartered Accountant and a financial expert within the meaning of such term under the *Sarbanes-Oxley Act of 2002*. The Audit Committee met four times during 2016.

The Audit Committee has established procedures for: (i) the receipt, retention and treatment of complaints received by us regarding accounting, internal accounting controls or auditing matters; and (ii) the confidential and anonymous submission by our employees and others of concerns regarding questionable accounting or auditing matters. A person wishing to notify us of such a complaint or concern should send a written notice thereof, marked Private & Confidential, to the Chairman of the Audit Committee, Mercer International Inc., c/o Suite 1120, 700 West Pender Street, Vancouver, British Columbia, Canada V6C 1G8.

### **Compensation and Human Resource Committee**

The Board has established a Compensation and Human Resource Committee. The Compensation and Human Resource Committee is responsible for reviewing and approving the strategy and design of our compensation, equity-based and benefits programs. The Compensation and Human Resource Committee functions pursuant to a charter adopted by the directors, a copy of which is available on our website at [www.mercerint.com](http://www.mercerint.com) in the Corporate Governance Guidelines under the Governance link. The Compensation and Human Resource Committee is also responsible for approving all compensation actions relating to executive officers. The members of the Compensation and Human Resource Committee are Mr. Picchi, Mr. Witts, Mr. Shepherd and Ms. Orr, each of whom is independent under applicable laws and regulations and the listing requirements of the NASDAQ Global Select Market. The Compensation and Human Resource Committee met four times during 2016.

### **Governance and Nominating Committee**

The Board has established a Governance and Nominating Committee comprised of Mr. Lauritzen, Mr. McCartney and Mr. Purchase, each of whom is independent under applicable laws and regulations and the listing requirements of the NASDAQ Global Select Market. The Governance and Nominating Committee functions pursuant to a charter adopted by the directors, a copy of which is incorporated by reference in the exhibits to this Form 10-K and is available on our website at [www.mercerint.com](http://www.mercerint.com) in the Corporate Governance Guidelines under the Governance link. The purpose of the committee is to: (i) manage the corporate governance system of the Board; (ii) assist the Board in fulfilling its duties to meet applicable legal and regulatory and self-regulatory business principles and codes of best practice; (iii) assist



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in the creation of a corporate culture and environment of integrity and accountability; (iv) in conjunction with the Lead Director, monitor the quality of the relationship between the Board and management; (v) review management succession plans; (vi) recommend to the Board nominees for appointment to the Board; (vii) lead the Board's annual review of the Chief Executive Officer's performance; and (viii) set the Board's forward meeting agenda. The Governance and Nominating Committee met five times in 2016.

### **Environmental, Health and Safety Committee**

The Board established an Environmental, Health and Safety Committee in 2006, currently comprised of Mr. Shepherd, Mr. Purchase and Mr. Lee, to review on behalf of the Board the policies and processes implemented by management, and the resulting impact and assessments of all our environmental, health and safety related activities. The Environmental, Health and Safety Committee functions pursuant to a charter adopted by the directors, a copy of which is available on our website at [www.mercerint.com](http://www.mercerint.com) in the Corporate Governance Guidelines under the Governance link. More specifically, the Environmental, Health and Safety Committee is to: (i) review and approve, and if necessary revise, our environmental, health and safety policies and environmental compliance programs; (ii) monitor our environmental, health and safety management systems including internal and external audit results and reporting; and (iii) provide direction to management on the frequency and focus of external independent environmental, health and safety audits. The Environmental, Health and Safety Committee met five times in 2016.

### **Lead Director/Deputy Chairman**

The Board appointed Mr. Lauritzen as Lead Director in 2012. The role of the Lead Director is to provide leadership to the non-management directors on the Board and to ensure that the Board can operate independently of management and that directors have an independent leadership contact. The duties of the Lead Director include, among other things: (i) ensuring that the Board has adequate resources to support its decision-making process and ensuring that the Board is appropriately approving strategy and supervising management's progress against that strategy; (ii) ensuring that the independent directors have adequate opportunity to meet to discuss issues without management being present; (iii) chairing meetings of directors in the absence of the Chairman and Chief Executive Officer; (iv) ensuring that delegated committee functions are carried out and reported to the Board; and (v) communicating to management, as appropriate, the results of private discussions among outside directors and acting as a liaison between the Board and the Chief Executive Officer.

### **Code of Business Conduct and Ethics and Anti-Corruption Policy**

The Board has adopted a Code of Business Conduct and Ethics that applies to our directors, employees and executive officers and an Anti-Corruption Policy. The code and the policy are available on our website at [www.mercerint.com](http://www.mercerint.com) under the Governance link. Copies of the code and the policy may also be obtained without charge upon request to Investor Relations, Mercer International Inc., Suite 1120, 700 West Pender Street, Vancouver, British Columbia, Canada V6C 1G8 (Telephone: (604) 684-1099).

### **Section 16(a) Beneficial Ownership Reporting Compliance**

The information required under Section 16(a) Beneficial Ownership Reporting Compliance is incorporated by reference from the proxy statement relating to our annual meeting to be held in 2017, which will be filed with the SEC within 120 days of our most recently completed fiscal year.



**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item 11 is incorporated by reference from the proxy statement relating to our annual meeting to be held in 2017, which will be filed with the SEC within 120 days of our most recently completed fiscal year.

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**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this Item 12 is incorporated by reference from the proxy statement relating to our annual meeting to be held in 2017, which will be filed with the SEC within 120 days of our most recently completed fiscal year.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

**Review, Approval or Ratification of Transactions with Related Persons**

Pursuant to the terms of the Audit Committee Charter, the Audit Committee is responsible for reviewing and approving the terms and conditions of all proposed transactions between us, any of our officers, directors or shareholders who beneficially own more than 5% of our outstanding shares of common stock, or relatives or affiliates of any such officers, directors or shareholders, to ensure that such related party transactions are fair and are in our overall best interest and that of our shareholders. In the case of transactions with employees, a portion of the review authority is delegated to supervising employees pursuant to the terms of our written Code of Business Conduct and Ethics.

The Audit Committee has not adopted any specific procedures for conduct of reviews and considers each transaction in light of the facts and circumstances. In the course of its review and approval of a transaction, the Audit Committee considers, among other factors it deems appropriate:

Whether the transaction is fair and reasonable to us;

The business reasons for the transaction;

Whether the transaction would impair the independence of one of our non-employee directors; and

Whether the transaction is material, taking into account the significance of the transaction.

Any member of the Audit Committee who is a related person with respect to a transaction under review may not participate in the deliberations or vote respecting approval or ratification of the transaction, provided, however, that such director may be counted in determining the presence of a quorum at a meeting of the committee that considers the transaction.

The information called for by Items 404(a) and 407(a) of Regulation S-K required to be included under this Item 13 is incorporated by reference from the proxy statement relating to our annual meeting to be held in 2017, which will be filed with the SEC within 120 days of our most recently completed fiscal year.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this Item 14 is incorporated by reference from the proxy statement relating to our annual meeting to be held in 2017, which will be filed with the SEC within 120 days of our most recently completed fiscal year.

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<b>(a) (1) Financial Statements</b>	<b>Page</b>
<u>Report of Independent Registered Public Accounting Firm</u>	91
<u>Consolidated Statements of Operations</u>	93
<u>Consolidated Statements of Comprehensive Income (Loss)</u>	94
<u>Consolidated Balance Sheets</u>	95
<u>Consolidated Statements of Changes in Shareholders' Equity</u>	96
<u>Consolidated Statements of Cash Flows</u>	97
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<b>(a)(2) Financial Statement Schedules</b>	

All schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

**(a)(3) Exhibits**

Exhibits that are not filed herewith have been previously filed with the SEC and are incorporated herein by reference.

- 3.1 Articles of Incorporation of Mercer International Inc., as amended. Incorporated by reference from Form 8-A filed March 2, 2006.
- 3.2 Bylaws of Mercer International Inc. Incorporated by reference from Form 8-A filed March 2, 2006.
- 4.1 Indenture dated November 26, 2014 between Mercer International Inc. and Wells Fargo Bank, National Association, as trustee, relating to the 2019 Senior Notes. Incorporated by reference from Form 8-K filed November 28, 2014.
- 4.2 Indenture dated November 26, 2014 between Mercer International Inc. and Wells Fargo Bank, National Association, as trustee, relating to the 2022 Senior Notes. Incorporated by reference from Form 8-K filed November 28, 2014.
- 4.3 Indenture dated February 3, 2017 between Mercer International Inc. and Wells Fargo Bank, National Association, as trustee, relating to the 2024 Senior Notes. Incorporated by reference from Form 8-K filed February 3, 2017.
- 10.1 Revolving Credit Facility Agreement dated November 25, 2014 among Zellstoff Stendal GmbH, UniCredit Bank AG, Credit Suisse AG, London Branch, Royal Bank of Canada and Barclays Bank PLC. Incorporated by reference from Form 8-K filed November 28, 2014.
- 10.2 Form of Trustee's Indemnity Agreement between Mercer International Inc. and its Trustees. Incorporated by reference from Form 10-K filed March 31, 2003.
- 10.3 2004 Stock Incentive Plan. Incorporated by reference from Form S-8 filed June 16, 2004.

- 10.4 Mercer International Inc. 2010 Stock Incentive Plan. Incorporated by reference from Appendix A to Mercer International Inc. s definitive proxy statement on Schedule 14A filed April 24, 2014.
- 10.5 Employment Agreement effective September 1, 2005 between Mercer International Inc. and Leonhard Nossol dated August 18, 2005. Incorporated by reference from Form 10-Q filed May 6, 2008.

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- 10.6 Employment Agreement dated October 20, 2005 between Mercer Pulp Sales GmbH and David Cooper. Incorporated by reference from Form 10-Q filed April 29, 2015.
- 10.7 Employment Agreement dated October 2, 2006 between Stendal Pulp Holding GmbH and Wolfram Ridder. Incorporated by reference from Form 8-K filed October 3, 2006.
- 10.8 Electricity Purchase Agreement effective January 27, 2009 between Zellstoff Celgar Limited Partnership and British Columbia Hydro and Power Authority. Incorporated by reference from Form 10-K filed March 2, 2009. Certain non-public information has been omitted from the appendices to Exhibit 10.9 pursuant to a request for confidential treatment filed with the SEC. Such non-public information was filed with the SEC on a confidential basis. The SEC approved the request for confidential treatment in March 2009.
- 10.9 Revolving Credit Facility Agreement dated August 19, 2009 among D&Z Holding GmbH, Zellstoff- und Papierfabrik Rosenthal GmbH, D&Z Beteiligungs GmbH and ZPR Logistik GmbH and Bayerische Hypo- und Vereinsbank AG. Incorporated by reference from Form 8-K filed August 24, 2009.
- 10.10 Extension, Amendment and Confirmation Letter dated October 4, 2012 among Zellstoff- und Papierfabrik Rosenthal GmbH, D&Z Holding GmbH, D&Z Beteiligungs GmbH, ZPR Logistik GmbH, Bayerische Hypo- und Vereinsbank AG and Mercer International Inc. Incorporated by reference from Form 10-Q filed November 2, 2012.
- 10.11 Second Amended and Restated Credit Agreement dated as of May 2, 2013 among Zellstoff Celgar Limited Partnership, as borrower, and the lenders from time to time parties thereto, as lenders, and Canadian Imperial Bank of Commerce, as agent. Incorporated by reference from Form 8-K filed May 8, 2013.
- 10.12 Second Extension, Amendment and Confirmation Letter dated February 5, 2016 among Zellstoff- und Papierfabrik Rosenthal GmbH, D&Z Holding GmbH, ZPR Logistik GmbH and Mercer International Inc. Incorporated by reference from Form 10-K filed February 12, 2016.
- 10.13 Employment Agreement between Mercer International Inc. and David Ure dated August 12, 2013. Incorporated by reference from Form 8-K filed on July 19, 2015.
- 10.14 First Amending Agreement dated October 21, 2014 between Zellstoff Celgar Limited Partnership, Mercer International Inc., as guarantor, and Canadian Imperial Bank of Commerce. Incorporated by reference from Form 10-Q filed October 31, 2014.
- 10.15 Amendment to Employment Agreement between Mercer International Inc. and David Ure, dated July 17, 2015. Incorporated by reference from Form 8-K filed July 19, 2015.
- 10.16 Second Amended and Restated Employment Agreement between Mercer International Inc. and Jimmy S.H. Lee, dated for reference September 29, 2015. Incorporated by reference from Form 8-K filed September 28, 2015.
- 10.17 Amended and Restated Employment Agreement between Mercer International Inc. and David M. Gandossi, dated for reference September 29, 2015. Incorporated by reference from Form 8-K filed September 28, 2015.
- 10.18 Registration Rights Agreement dated February 3, 2017 between Mercer International Inc. and Credit Suisse Securities (USA) LLC, related to the 2024 Senior Notes. Incorporated by reference from Form 8-K filed on February 3, 2017.
- 14.1 Code of Business Conduct and Ethics. Incorporated by reference from Mercer International Inc.'s definitive proxy statement on Schedule 14A filed August 11, 2003.

21.1\* List of Subsidiaries of Registrant.

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23.1*	Consent of PricewaterhouseCoopers LLP.
31.1*	Section 302 Certificate of Chief Executive Officer.
31.2*	Section 302 Certificate of Chief Financial Officer.
32.1*	Section 906 Certificate of Chief Executive Officer.
32.2*	Section 906 Certificate of Chief Financial Officer.
101*	The following financial statements from the Company's annual report on Form 10-K for the year ended December 31, 2016, filed with the SEC on February 10, 2017, formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Statements of Operations; (ii) Consolidated Statements of Comprehensive Income (Loss); (iii) Consolidated Balance Sheets; (iv) Consolidated Statements of Changes in Shareholders' Equity; (v) Consolidated Statements of Cash Flows; and (vi) Notes to the Consolidated Financial Statements.

\* Filed herewith.

Denotes management contract or compensatory plan or arrangement.



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**Report of Independent Registered Public Accounting Firm**

**To the Shareholders and Board of Directors of**

**Mercer International Inc.**

We have audited the accompanying consolidated balance sheets and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity and cash flows of Mercer International Inc. and its subsidiaries as of December 31, 2016 and December 31, 2015 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016. We also have audited Mercer International Inc.'s and its subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express an opinion on these consolidated financial statements, and an opinion on the company's internal control over financial reporting based on our integrated audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall consolidated financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mercer International Inc. and its subsidiaries as of December 31, 2016 and December 31, 2015 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, Mercer International Inc. and its subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

/s/ PricewaterhouseCoopers LLP

**Chartered Professional Accountants**

Vancouver, British Columbia

February 10, 2017

Table of Contents**MERCER INTERNATIONAL INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands of U.S. dollars, except per share data)**

	<b>For the Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Revenues</b>			
Pulp	\$ 847,328	\$ 946,237	\$ 1,073,632
Energy and chemicals	84,295	86,967	101,480
	931,623	1,033,204	1,175,112
<b>Costs and expenses</b>			
Operating costs, excluding depreciation and amortization	701,875	753,523	887,712
Operating depreciation and amortization	71,476	67,761	77,675
Selling, general and administrative expenses	44,529	46,236	47,927
<b>Operating income</b>	<b>113,743</b>	<b>165,684</b>	<b>161,798</b>
<b>Other income (expenses)</b>			
Interest expense	(51,575)	(53,891)	(67,516)
Foreign exchange loss on intercompany debt	(1,140)	(5,306)	(4,777)
Gain (loss) on derivative instruments (Note 13)	(241)	(935)	11,501
Other income (expenses)	(1,323)	(601)	3,186
<b>Total other expenses</b>	<b>(54,279)</b>	<b>(60,733)</b>	<b>(57,606)</b>
<b>Income before provision for income taxes</b>	<b>59,464</b>	<b>104,951</b>	<b>104,192</b>
<b>Current income tax provision (Note 8)</b>	<b>(7,712)</b>	<b>(11,934)</b>	<b>(5,242)</b>
<b>Deferred income tax benefit (provision) (Note 8)</b>	<b>(16,809)</b>	<b>(17,515)</b>	<b>22,016</b>
<b>Net income</b>	<b>34,943</b>	<b>75,502</b>	<b>120,966</b>
Less: net income attributable to noncontrolling interest			(7,812)
<b>Net income attributable to common shareholders</b>	<b>\$ 34,943</b>	<b>\$ 75,502</b>	<b>\$ 113,154</b>
<b>Net income per share attributable to common shareholders (Note 10)</b>			
Basic	\$ 0.54	\$ 1.17	\$ 1.82
Diluted	\$ 0.54	\$ 1.17	\$ 1.81
	\$ 0.46	\$ 0.23	\$

Dividends declared per share attributable to common  
shareholders (Note 9)

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

Table of Contents**MERCER INTERNATIONAL INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(In thousands of U.S. dollars)**

	<b>For the Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net income	\$ 34,943	\$ 75,502	\$ 120,966
Other comprehensive income (loss), net of taxes <sup>(1)</sup>			
Foreign currency translation adjustment	(14,369)	(122,955)	(81,024)
Change in unrecognized losses and prior service costs related to defined benefit pension plan	675	3,949	(2,873)
Change in unrealized gains/losses on marketable securities	(1)	(127)	(14)
Other comprehensive loss, net of taxes	(13,695)	(119,133)	(83,911)
Total comprehensive income (loss)	21,248	(43,631)	37,055
Comprehensive income attributable to noncontrolling interest			(7,812)
Comprehensive income (loss) attributable to common shareholders	\$ 21,248	\$ (43,631)	\$ 29,243

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

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

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**MERCER INTERNATIONAL INC.**  
**CONSOLIDATED BALANCE SHEETS**

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

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 136,569	\$ 99,629
Restricted cash (Note 13)	4,327	9,230
Accounts receivable (Note 2)	123,892	134,254
Inventories (Note 3)	133,451	141,001
Prepaid expenses and other	3,612	4,697
<b>Total current assets</b>	<b>401,851</b>	<b>388,811</b>
Property, plant and equipment, net (Note 4)	738,276	762,391
Intangible and other assets	7,591	8,461
Deferred income tax (Note 8)	10,990	23,154
<b>Total assets</b>	<b>\$ 1,158,708</b>	<b>\$ 1,182,817</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable and other (Note 5)	\$ 92,133	\$ 103,450
Pension and other post-retirement benefit obligations (Note 7)	1,037	971
<b>Total current liabilities</b>	<b>93,170</b>	<b>104,421</b>
Debt (Note 6)	617,545	638,043
Interest rate derivative liability (Note 13)		6,533
Pension and other post-retirement benefit obligations (Note 7)	25,084	25,374
Capital leases and other (Note 15)	26,467	12,299
Deferred income tax (Note 8)	17,314	13,171
<b>Total liabilities</b>	<b>779,580</b>	<b>799,841</b>
Shareholders' equity		
Common shares \$1 par value; 200,000,000 authorized;		
64,694,000 issued and outstanding (2015 64,502,000)	64,656	64,424
Additional paid-in capital	333,673	329,246

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Retained earnings	166,068	160,880
Accumulated other comprehensive loss (Note 11)	(185,269)	(171,574)
Total shareholders' equity	379,128	382,976
Total liabilities and shareholders' equity	\$ 1,158,708	\$ 1,182,817
Commitments and contingencies (Note 16)		
Subsequent events (Note 6(a), 9)		

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

Table of Contents**MERCER INTERNATIONAL INC.****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

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

	Common shares				Accumulated		Noncontrolling	
	Number	Amount, at	Additional	Retained	Other	Shareholders	Interest	Total
	(thousands of	Par Value	Paid-in	Earnings	Comprehensive	Equity	(Deficit)	Equity
	shares)		Capital	(Deficit)	Income (Loss)			
Balance, December 31, 2013	55,854	\$ 55,696	\$ 261,097	\$ 10,815	\$ 31,470	\$ 359,078	\$ (10,761)	\$ 348,317
Shares issued through public offering	8,050	8,050	45,809			53,859		53,859
Shares issued pursuant to restricted stock awards	38	78	(78)					
Shares issued pursuant to performance units	332	332	(332)					
Share-based compensation expense			1,470			1,470		1,470
Share-based income				113,154		113,154	7,812	120,966
Acquisition of controlling interest in the Adal mill			18,985	(23,755)		(4,770)	2,949	(1,840)
Other comprehensive income					(83,911)	(83,911)		(83,911)
Balance, December 31, 2014	64,274	64,156	326,951	100,214	(52,441)	438,880		438,880
Shares issued pursuant to restricted stock awards	38	78	(78)					
Shares issued pursuant to grants of	160	160	(160)					



Performance								
units								
shares issued								
exercise of								
warrant options	30	30	(30)					
stock								
compensation								
expense			2,563			2,563		2,563
income				75,502		75,502		75,502
dividends								
paid				(14,836)		(14,836)		(14,836)
other								
comprehensive					(119,133)	(119,133)		(119,133)
Balance,								
December 31,								
2015	64,502	64,424	329,246	160,880	(171,574)	382,976		382,976
shares issued								
under grants of								
restricted								
stock								
options	38	78	(78)					
shares issued								
under grants of								
performance								
units	154	154	(154)					
stock								
compensation								
expense			4,659			4,659		4,659
income				34,943		34,943		34,943
dividends								
paid				(29,755)		(29,755)		(29,755)
other								
comprehensive					(13,695)	(13,695)		(13,695)
Balance,								
December 31,								
2016	64,694	\$ 64,656	\$ 333,673	\$ 166,068	\$ (185,269)	\$ 379,128	\$	\$ 379,128

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

Table of Contents**MERCER INTERNATIONAL INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands of U.S. dollars)**

	<b>For the Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Cash flows from (used in) operating activities</b>			
Net income	\$ 34,943	\$ 75,502	\$ 120,966
<b>Adjustments to reconcile net income to cash flows from operating activities</b>			
Unrealized (gain) loss on derivative instruments	181	573	(11,501)
Depreciation and amortization	71,984	68,333	78,012
Deferred income tax (benefit) provision	16,809	17,515	(22,016)
Foreign exchange loss on intercompany debt	1,140	5,306	4,777
Defined benefit pension plan and other post-retirement benefit plan expense	1,955	2,162	2,475
Stock compensation expense	4,659	2,409	1,586
Other	3,715	2,756	(1,281)
Defined benefit pension plan and other post-retirement benefit plan contributions	(2,316)	(2,349)	(2,951)
<b>Changes in working capital</b>			
Accounts receivable	9,466	(11,256)	(25,113)
Inventories	6,844	(13,235)	6,445
Accounts payable and accrued expenses	(10,274)	9,665	(5,382)
Other	1,676	1,839	(1,429)
<b>Net cash from (used in) operating activities</b>	<b>140,782</b>	<b>159,220</b>	<b>144,588</b>
<b>Cash flows from (used in) investing activities</b>			
Purchase of property, plant and equipment	(42,526)	(46,536)	(34,612)
Purchase of intangible assets	(1,844)	(3,809)	(4,776)
Other	67	528	910
<b>Net cash from (used in) investing activities</b>	<b>(44,303)</b>	<b>(49,817)</b>	<b>(38,478)</b>
<b>Cash flows from (used in) financing activities</b>			
Repurchase of notes and repayment of debt	(23,079)	(10,763)	(891,019)
Proceeds from issuance of notes			650,000
Proceeds from issuance of shares			53,859
Dividend payments	(29,733)	(7,418)	
Proceeds from (repayment of) revolving credit facilities, net		(23,058)	26,254

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Payment of interest rate derivative liability	(10,883)	(13,530)	
Payment of debt issuance costs		(326)	(20,169)
Proceeds from government grants	2,988	158	6,699
Other	(1,670)	(1,727)	(1,376)
<b>Net cash from (used in) financing activities</b>	<b>(62,377)</b>	<b>(56,664)</b>	<b>(175,752)</b>
<b>Effect of exchange rate changes on cash, cash equivalents and restricted cash</b>	<b>(2,065)</b>	<b>(7,338)</b>	<b>(14,628)</b>
<b>Net increase (decrease) in cash, cash equivalents and restricted cash</b>	<b>32,037</b>	<b>45,401</b>	<b>(84,270)</b>
Cash, cash equivalents and restricted cash, beginning of year	108,859	63,458	147,728
Cash, cash equivalents and restricted cash, end of year	\$ 140,896	\$ 108,859	\$ 63,458
<b>Supplemental cash flow disclosure</b>			
Cash paid for interest	\$ 50,159	\$ 51,975	\$ 65,013
Cash paid for income taxes	\$ 13,352	\$ 8,784	\$ 3,718
<b>Supplemental schedule of non-cash investing and financing activities</b>			
Payment-in-kind note issued to acquire noncontrolling interest	\$	\$	\$ 12,101
<i>The accompanying notes are an integral part of these consolidated financial statements.</i>			

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**MERCER INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

**Note 1. The Company and Summary of Significant Accounting Policies**

**Background**

Mercer International Inc. ( Mercer Inc. ) is a Washington corporation and its shares of common stock are quoted and listed for trading on the NASDAQ Global Market and the Toronto Stock Exchange.

Mercer Inc. operates three pulp manufacturing facilities, one in Canada and two in Germany, and is one of the largest producers of market northern bleached softwood kraft ( NBSK ) pulp in the world.

In these consolidated financial statements, unless otherwise indicated, all amounts are expressed in U.S. dollars ( \$ ). The symbol € refers to euros and the symbol C\$ refers to Canadian dollars.

**Basis of Presentation**

These consolidated financial statements contained herein include the accounts of Mercer Inc. and all of its subsidiaries (collectively, the Company ). The Company s consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. ( GAAP ). All significant intercompany balances and transactions have been eliminated upon consolidation.

**Use of Estimates**

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

**Significant Accounting Policies**

*Cash and Cash Equivalents and Restricted Cash*

Cash and cash equivalents include cash held in bank accounts and highly liquid investments with original maturities of three months or less. Restricted cash is comprised of cash deposits that cannot be withdrawn without prior notice or penalty.

*Accounts Receivable*

Accounts receivable are recorded at cost, net of an allowance for doubtful accounts. The Company reviews the collectability of receivables at each reporting date. The Company maintains an allowance for doubtful accounts at an

amount estimated to cover the potential losses on certain uninsured receivables. Any amounts that are determined to be uncollectible and uninsured are offset against the allowance. The allowance is based on the Company's evaluation of numerous factors, including the payment history and financial position of the debtors. For certain customers the Company receives a letter of credit prior to shipping its product.

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**MERCER INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

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

*Inventories*

Inventories of raw materials, finished goods and work in progress are valued at the lower of cost, using the weighted-average cost method, or net realizable value. Other materials and spare parts are valued at the lower of cost and replacement cost. Cost includes labor, materials and production overhead and is determined by using the weighted average cost method. Raw materials inventories include both roundwood (logs) and wood chips. These inventories are located both at the pulp mills and at various offsite locations. In accordance with industry practice, physical inventory counts utilize standardized techniques to estimate quantities of roundwood and wood chip inventory volumes. These techniques historically have provided reasonable estimates of such inventories.

*Property, Plant and Equipment*

Property, plant and equipment is stated at cost less accumulated depreciation. Depreciation of buildings and production equipment is based on the estimated useful lives of the assets and is computed using the straight-line method. Buildings are depreciated over 10 to 50 years and production equipment and other primarily over 25 years.

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. To determine recoverability, the Company compares the carrying value of the assets to the estimated future undiscounted cash flows. Measurement of an impairment loss for long-lived assets held for use is based on the fair value of the asset.

The costs of major rebuilds, replacements and those expenditures that substantially increase the useful lives of existing property, plant, and equipment are capitalized, as well as interest costs associated with major capital projects until ready for their intended use. The cost of repairs and maintenance as well as planned shutdown maintenance performed on manufacturing facilities, composed of labor, materials and other incremental costs, is recognized as an expense in the Consolidated Statement of Operations as incurred.

Leases which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item are capitalized at the present value of the minimum lease payments. Capital leases are depreciated over the lease term. Operating lease payments are recognized as an expense in the Consolidated Statement of Operations on a straight-line basis over the lease term.

The Company provides for asset retirement obligations when there is a legislated or contractual basis for those obligations. An obligation is recorded as a liability at fair value in the period in which the Company incurs a legal obligation associated with the retirement of an asset. The associated costs are capitalized as part of the carrying value of the related asset and amortized over its remaining useful life. The liability is accreted using a risk-free interest rate.

*Government Grants*

The Company records investment grants from federal and state governments when the conditions of their receipt are complied with and there is reasonable assurance that the grants will be received. Grants related to assets are government grants whose primary condition is that the company qualifying for them should

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**MERCER INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

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

purchase, construct or otherwise acquire long-term assets. Secondary conditions may also be attached, including restricting the type or location of the assets and/or other conditions that must be met. Grants related to assets are deducted from the cost of the assets in the Consolidated Balance Sheet.

Grants related to income are government grants which are either unconditional, related to reduced environmental emissions or related to the Company's normal business operations, and are reported as a reduction of related expenses in the Consolidated Statement of Operations when the conditions of their receipt are complied with and there is reasonable assurance that the grants will be received.

The Company is required to pay certain fees based on wastewater emissions at its German mills. Accrued fees can be reduced upon the mills' demonstration of reduced wastewater emissions. The fees are expensed as incurred and the fee reduction is recognized once the Company has reasonable assurance that the German regulators will accept the reduced level of wastewater emissions. There may be a significant period of time between recognition of the wastewater expense and recognition of the wastewater fee reduction.

*Pension Plans*

The Company maintains a defined benefit pension plan for its salaried employees at its Celgar mill which is funded and non-contributory. The cost of the benefits earned by the salaried employees is determined using the projected benefit method prorated on services. The pension expense reflects the current service cost, the interest on the unfunded liability and the amortization over the estimated average remaining service life of the employees of (i) prior service costs, and (ii) the net actuarial gain or loss that exceeds 10% of the greater of the accrued benefit obligation and the fair value of plan assets as at the beginning of the year. The Company recognizes the net funded status of the plan.

In addition, hourly-paid employees at the Celgar mill are covered by a multiemployer pension plan for which contributions are charged against earnings in the Consolidated Statement of Operations.

*Foreign Operations and Currency Translation*

The Company determines its foreign subsidiaries' functional currency by reviewing the currency of the primary economic environment in which the foreign subsidiaries operate, which is normally the currency of the environment in which the foreign subsidiaries generate and expend cash. The Company translates assets and liabilities of its non-U.S. dollar functional currency subsidiaries into U.S. dollars using the rate in effect at the balance sheet date and revenues and expenses are translated at the average rate of exchange throughout the period. Foreign currency translation gains and losses are recognized within accumulated other comprehensive loss in shareholders' equity.



Transactions in foreign currencies are translated to the respective functional currencies of each operation using exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency using the exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies are translated to the functional currency using historical exchange rates. Gains and losses resulting from foreign currency transactions related to operating activities are included in costs and expenses while those related to non-operating activities are included in other income (expenses) in the Consolidated Statement of Operations.

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**MERCER INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

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

Where intercompany loans are of a long-term investment nature, exchange rate changes are included as a foreign currency translation adjustment within accumulated other comprehensive loss in shareholders' equity.

*Revenue Recognition*

The Company recognizes revenue from pulp and chemical sales when persuasive evidence of an arrangement exists, the sales price is fixed or determinable, title of ownership and risk of loss have passed to the customer and collectability is reasonably assured. Sales are reported net of discounts and allowances.

The Company reports revenue from sales of surplus electricity and the sale of chemicals as energy and chemicals revenue in the Consolidated Statement of Operations. Energy revenues are recognized as the electricity is consumed by customers and when collection is reasonably assured. These revenues include an estimate of the value of electricity transferred to customers in the period but billed subsequent to period-end. Customer bills are based on agreed upon rates and meter readings that indicate electricity consumption.

*Shipping and Handling Costs*

Amounts charged to customers for shipping and handling costs are recognized as revenue in the Consolidated Statement of Operations. Shipping and handling costs incurred by the Company are included in operating costs in the Consolidated Statement of Operations.

*Stock-Based Compensation*

The Company recognizes stock-based compensation expense over an award's requisite service period based on the award's fair value in selling, general, and administrative expenses within the Consolidated Statement of Operations. The Company issues new shares upon the exercise of stock-based compensation awards.

For performance share units (PSUs) which have the same grant and service inception date, the fair value is based upon the targeted number of shares to be awarded and the quoted market price of the Company's shares at that date. For PSUs where the service inception date precedes the grant date, the fair value is based upon the targeted number of shares awarded and the quoted price of the Company's shares at each reporting date up to the grant date. The target number of shares is determined using management's best estimate. The final determination of the number of shares to be granted is made by the Company's Board of Directors. The Company estimates forfeitures of PSUs based on management's expectations and recognizes compensation cost only for those awards expected to vest. Estimated forfeitures are adjusted to actual experience at each balance sheet date.

The fair value of restricted shares is determined based upon the number of shares granted and the quoted price of the Company's shares on the date of grant.

*Deferred Income Taxes*

Deferred income taxes are recognized using the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis, and operating loss

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**MERCER INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

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

and tax credit carryforwards. Valuation allowances are provided if, after considering both positive and negative available evidence, it is more likely than not that some or all of the net deferred tax assets will not be realized.

Deferred income taxes are determined separately for each tax-paying component of the Company. For each tax-paying component, all deferred tax liabilities and assets are offset and presented as a single net amount.

*Derivative Financial Instruments*

The Company occasionally enters into derivative financial instruments to manage certain market risks. These derivative instruments are not designated as hedging instruments and accordingly, are recorded at fair value on the Consolidated Balance Sheet with the changes in fair value recognized in gain (loss) on derivative instruments in the Consolidated Statement of Operations. Periodically, the Company enters into derivative contracts to supply materials for its own use and as such are exempt from mark-to-market accounting.

*Fair Value Measurements*

The fair value methodologies and, as a result, the fair value of the Company's financial instruments are determined based on the fair value hierarchy provided in the Fair Value Measurements and Disclosures topic of the Financial Accounting Standards Board ( FASB ) Accounting Standards Codification, and are as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets and liabilities.

Level 2 Valuations based on observable inputs in active markets for similar assets and liabilities, other than Level 1 prices, such as quoted commodity prices or interest or currency exchange rates.

Level 3 Valuations based on significant unobservable inputs that are supported by little or no market activity, such as discounted cash flow methodologies based on internal cash flow forecasts.

The financial instrument's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

*Net Income Per Share Attributable to Common Shareholders*

Basic net income per share attributable to common shareholders is computed by dividing net income attributable to common shareholders by the weighted average number of common shares outstanding in the period. Diluted net income per share attributable to common shareholders is calculated to give effect to all potentially dilutive common shares outstanding by applying the Treasury Stock and If-Converted methods. Instruments that could have a potentially dilutive effect on the Company's weighted average shares outstanding include all or a portion of

outstanding stock options, restricted shares, restricted share units, performance shares and PSUs.

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**MERCER INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

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

**New Accounting Pronouncements**

*Accounting Pronouncements Implemented*

In August 2016, the FASB issued Accounting Standards Update 2016-15, Classification of Certain Cash Receipts and Cash Payments ( ASU 2016-15 ) which is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. This standard is effective for financial statements issued for fiscal years beginning after December 15, 2017 and should be applied retrospectively to all periods presented. Early adoption is permitted for all entities at the beginning of an interim or annual reporting period. The Company has elected to early adopt ASU 2016-15 in the fourth quarter of 2016 for which there was no material impact to the classification of balances in the Consolidated Statement of Cash Flows for all periods presented.

In November 2016, the FASB issued Accounting Standards Update 2016-18, Restricted Cash ( ASU 2016-18 ) which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. This standard is effective for financial statements issued for fiscal years beginning after December 15, 2017 and should be applied retrospectively to all periods presented. Early adoption is permitted for all entities at the beginning of an interim or annual reporting period. The Company has elected to early adopt ASU 2016-18 in the fourth quarter of 2016 and as at December 31, 2016, the restricted cash balance of \$4,327 has been included in cash and cash equivalents and restricted cash on the Consolidated Statement of Cash Flows. For the years ended December 31, 2015 and 2014, \$nil and an increase of \$10,627, respectively, in restricted cash has been reclassified from cash flows from (used) in investing activities to cash and cash equivalents and restricted cash on the Consolidated Statement of Cash Flows.

*Accounting Pronouncements Not Yet Implemented*

In May 2014, the FASB issued Accounting Standards Update 2014-9, Revenue Recognition – Revenue from Contracts with Customers ( ASU 2014-9 ) that requires companies to recognize revenue when a customer obtains control rather than when companies have transferred substantially all risks and rewards of a good or service. In 2016 the FASB issued the following Accounting Standards which further affect the guidance of ASU 2014-09:

March 2016: ASU 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross versus Net);

April 2016: ASU 2016-10, Identifying Performance Obligations and Licensing; and

May 2016: ASU 2016-12, Revenue from Contracts with Customers: Narrow Scope Improvements and Practical Expedients.

These standards are effective for annual reporting periods beginning on or after December 15, 2017 with early adoption permitted at the beginning of an interim or annual reporting period beginning after December 15, 2016. Currently, the Company believes this new standard will not have a material impact on its consolidated financial statements, however, its assessment of this standard is ongoing. The Company expects to adopt this standard as of January 1, 2018.

**Table of Contents****MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 1. The Company and Summary of Significant Accounting Policies (continued)**

In July 2015, the FASB issued Accounting Standards Update 2015-11, Simplifying the Measurement of Inventory ( ASU 2015-11 ) which requires that inventory within the scope of this update, including inventory stated at average cost, be measured at the lower of cost and net realizable value. This update is effective for financial statements issued for fiscal years beginning after December 15, 2016, with early adoption permitted as of the beginning of an interim or annual reporting period. The adoption of ASU 2015-11 will not materially impact the Company's financial position.

In February 2016, the FASB issued Accounting Standards Update 2016-2, Leases ( ASU 2016-2 ) which requires lessees to recognize virtually all of their leases on the balance sheet, by recording a right-of-use asset and liability. This update is effective for financial statements issued for fiscal years beginning after December 15, 2018, with early adoption permitted at the beginning of an interim or annual reporting period. The Company is currently assessing the impact the adoption of ASU 2016-2 will have on its consolidated financial statements.

In March 2016, the FASB issued Accounting Standards Update 2016-9, Improvements to Employee Share-Based Payment Accounting ( ASU 2016-9 ) which simplifies several aspects of accounting for share-based payment transactions including income tax consequences, classification of awards as either equity or liabilities, classification on the statement of cash flows and accounting for forfeitures. This update is effective for financial statements issued for fiscal years beginning after December 15, 2016. The Company is currently assessing the impact, if any, the adoption of ASU 2016-9 will have on its consolidated financial statements.

In October 2016, the FASB issued Accounting Standards Update 2016-16, Intra-Entity Transfers of Assets Other Than Inventory ( ASU 2016-16 ) which eliminates the deferral of the tax effects of intra-entity asset transfers other than inventory until the transferred assets are sold to a third party or recovered through use. This update is effective on a modified retrospective approach for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company is currently assessing the impact the adoption of ASU 2016-16 will have on its consolidated financial statements.

**Note 2. Accounts Receivable**

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
Sale of pulp, energy and chemicals, net of allowance of \$18 (2015 \$15)	\$ 118,434	\$ 119,359
Other non-trade receivables	5,458	14,895
	<b>\$ 123,892</b>	<b>\$ 134,254</b>

**Note 3. Inventories**



	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
Raw materials	\$ 50,056	\$ 57,592
Finished goods	33,510	36,829
Spare parts and other	49,885	46,580
	\$ 133,451	\$ 141,001

Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 4. Property, Plant and Equipment**

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
Land	\$ 27,139	\$ 27,625
Buildings	156,110	154,047
Production and other equipment	1,326,046	1,299,076
	1,509,295	1,480,748
Less: accumulated depreciation	(771,019)	(718,357)
	\$ 738,276	\$ 762,391

As at December 31, 2016, property, plant and equipment was net of \$233,186 of unamortized government investment grants (2015 \$253,178). As at December 31, 2016, included in production and other equipment is equipment under capital leases which had gross amounts of \$31,916 (2015 \$16,233), and accumulated depreciation of \$9,712 (2015 \$8,395). During the year ended December 31, 2016, production and other equipment totaling \$17,792 was acquired under capital lease obligations (2015 \$70; 2014 \$2,960) primarily related to the leasing of new customized railcars in Germany.

The Company maintains industrial landfills on its premises for the disposal of waste, primarily from the mills pulp processing activities. The mills have obligations under their landfill permits to decommission these disposal facilities pursuant to certain regulations. As at December 31, 2016, the Company had recorded \$4,716 (2015 \$4,620) of asset retirement obligations in capital leases and other in the Consolidated Balance Sheet.

**Note 5. Accounts Payable and Other**

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
Trade payables	\$ 28,815	\$ 20,637
Accrued expenses	39,903	55,648
Interest rate derivative liability, current portion (Note 13)	6,522	10,380
Dividends payable (Note 9)	7,440	7,418
Other	9,453	9,367
	\$ 92,133	\$ 103,450



Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 6. Debt**

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
2019 Senior Notes, unsecured, \$227,000 face value (a)	\$ 224,085	\$ 245,689
2022 Senior Notes, unsecured, \$400,000 face value (a)	393,460	392,354
Revolving credit facilities		
75.0 million (b)		
C\$40.0 million (c)		
25.0 million (d)		
5.0 million (e)		
	\$ 617,545	\$ 638,043

As at December 31, 2016, the maturities of the principal portion of debt are as follows:

2017	\$
2018	
2019	227,000
2020	
2021	
Thereafter	400,000
	\$ 627,000

Certain of the Company's debt instruments were issued under agreements which, among other things, may limit its ability and the ability of its subsidiaries to make certain payments, including dividends. These limitations are subject to specific exceptions. As at December 31, 2016, the Company is in compliance with the terms of its debt agreements.

- (a) On November 26, 2014, the Company issued \$650,000 of senior notes consisting of \$250,000 in aggregate principal amount of 7.00% senior notes which mature on December 1, 2019 ( 2019 Senior Notes ) and \$400,000 in aggregate principal amount of 7.75% senior notes which mature on December 1, 2022 ( 2022 Senior Notes ) and collectively with the 2019 Senior Notes, the Senior Notes ). The Senior Notes were issued at a price of 100% of their principal amount. Upon their issuance the Senior Notes were recorded at \$635,949 which included debt

issuance costs of \$14,051. These costs were proportionally allocated to the 2019 Senior Notes and the 2022 Senior Notes.

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

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**MERCER INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

**Note 6. Debt (continued)**

The Company may redeem all or a part of the Senior Notes, upon not less than 30 days or more than 60 days notice, at the redemption prices (expressed as percentages of principal amount) discussed below, plus accrued and unpaid interest to (but not including) the applicable redemption date. The 2019 Senior Notes redemption prices are equal to 103.50% for the twelve month period beginning on December 1, 2016, 101.75% for the twelve month period beginning on December 1, 2017, and 100.00% beginning on December 1, 2018 and at any time thereafter. The 2022 Senior Notes redemption prices are equal to 105.813% for the twelve month period beginning on December 1, 2017, 103.875% for the twelve month period beginning on December 1, 2018, 101.938% for the twelve month period beginning on December 1, 2019, and 100.00% beginning on December 1, 2020 and at any time thereafter.

In March 2016, the Company purchased \$23,000 in aggregate principal amount of its 2019 Senior Notes. In connection with this purchase the Company recorded a loss on extinguishment of debt of \$454 in other income (expenses) in the Consolidated Statement of Operations which included the write-off of certain unamortized debt issuance costs.

In February 2017, the Company issued \$225,000 in aggregate principal amount of 6.50% senior notes which mature on February 1, 2024. The net proceeds of this offering, along with cash on hand, will be used to purchase the remaining \$227,000 in aggregate principal amount of outstanding 2019 Senior Notes.

- (b) A 75.0 million revolving credit facility at the Stendal mill that matures in October 2019. Borrowings under the facility are collateralized by the mill's inventory and accounts receivable and bear interest at Euribor plus 3.50%. As at December 31, 2016, approximately 75.0 million (\$79,148) was available.
- (c) A C\$40.0 million revolving credit facility at the Celgar mill that matures in May 2019. Borrowings under the facility are collateralized by the mill's inventory and accounts receivable and are restricted by a borrowing base calculated on the mill's inventory and accounts receivable. Canadian dollar denominated amounts bear interest at bankers acceptance plus 1.50% or Canadian prime. U.S. dollar denominated amounts bear interest at LIBOR plus 1.50% or U.S. base. As at December 31, 2016, approximately C\$1.7 million (\$1,265) was supporting letters of credit and approximately C\$38.3 million (\$28,525) was available.
- (d) A 25.0 million revolving credit facility at the Rosenthal mill that matures in October 2019. Borrowings under the facility are collateralized by the mill's inventory and accounts receivable and bear interest at Euribor plus 2.95%. As at December 31, 2016, approximately 3.1 million (\$3,230) of this facility was supporting bank guarantees leaving approximately 21.9 million (\$23,152) available.

- (e) A 5.0 million revolving credit facility at the Rosenthal mill that matures in December 2018. Borrowings under this facility bear interest at the rate of the three-month Euribor plus 2.50% and are secured by certain land at the Rosenthal mill. As at December 31, 2016 approximately 3.2 million (\$3,359) of this facility was supporting bank guarantees leaving approximately 1.8 million (\$1,918) available.

Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 7. Pension and Other Post-Retirement Benefit Obligations****Defined Benefit Plans**

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

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

Information about the Celgar Defined Benefit Plans, in aggregate for the year ended December 31, 2016 was as follows:

	<b>Pension</b>	<b>2016 Other Post- Retirement Benefits</b>	<b>Total</b>
Change in benefit obligation			
Benefit obligation, December 31, 2015	\$ 34,426	\$ 21,278	\$ 55,704
Service cost	91	483	574
Interest cost	1,396	894	2,290
Benefit payments	(2,329)	(633)	(2,962)
Actuarial losses	479	1,278	1,757
Foreign currency exchange rate changes	1,062	628	1,690
Benefit obligation, December 31, 2016	35,125	23,928	59,053
Reconciliation of fair value of plan assets			
Fair value of plan assets, December 31, 2015	29,446		29,446
Actual returns	3,342		3,342
Contributions	1,683	633	2,316
Benefit payments	(2,329)	(633)	(2,962)
Foreign currency exchange rate changes	869		869
Fair value of plan assets, December 31, 2016	33,011		33,011



Funded status, December 31, 2016 <sup>(1)</sup>	\$	(2,114)	\$	(23,928)	\$	(26,042)
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Components of the net benefit cost recognized

Service cost	\$	91	\$	483	\$	574
Interest cost		1,396		894		2,290
Expected return on plan assets		(1,926)				(1,926)
Amortization of unrecognized items		1,169		(152)		1,017
Net benefit costs	\$	730	\$	1,225	\$	1,955

(1) The total of \$26,121 on the Consolidated Balance Sheet also includes pension liabilities of \$79 relating to employees at the Company's Rosenthal mill.

Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 7. Pension and Other Post-Retirement Benefit Obligations (continued)**

Information about the Celgar Defined Benefit Plans, in aggregate for the year ended December 31, 2015 was as follows:

	<b>Pension</b>	<b>2015 Other Post- Retirement Benefits</b>	<b>Total</b>
<b>Change in benefit obligation</b>			
Benefit obligation, December 31, 2014	\$ 43,073	\$ 28,465	\$ 71,538
Service cost	121	798	919
Interest cost	1,427	984	2,411
Benefit payments	(2,345)	(587)	(2,932)
Actuarial gains	(1,021)	(3,988)	(5,009)
Foreign currency exchange rate changes	(6,829)	(4,394)	(11,223)
 Benefit obligation, December 31, 2015	 34,426	 21,278	 55,704
 <b>Reconciliation of fair value of plan assets</b>			
Fair value of plan assets, December 31, 2014	35,653		35,653
Actual returns	107		107
Contributions	1,762	587	2,349
Benefit payments	(2,345)	(587)	(2,932)
Foreign currency exchange rate changes	(5,731)		(5,731)
 Fair value of plan assets, December 31, 2015	 29,446		 29,446
 Funded status, December 31, 2015 <sup>(1)</sup>	 \$ (4,980)	 \$ (21,278)	 \$ (26,258)
 <b>Components of the net benefit cost recognized</b>			
Service cost	\$ 121	\$ 798	\$ 919
Interest cost	1,427	984	2,411
Expected return on plan assets	(2,054)		(2,054)
Amortization of unrecognized items	878	8	886

Net benefit costs	\$	372	\$	1,790	\$	2,162
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(1) The total of \$26,345 on the Consolidated Balance Sheet also includes pension liabilities of \$87 relating to employees at the Company's Rosenthal mill.

The amortization of unrecognized items relates to net actuarial losses and prior service costs. The Company expects to recognize approximately \$836 of net actuarial losses and prior service costs in 2017. The Celgar Defined Benefit Plans do not have any net transition asset or obligation recognized as a reclassification adjustment of other comprehensive income. There are no plan assets that are expected to be returned to the Company in 2017.

Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 7. Pension and Other Post-Retirement Benefit Obligations (continued)**

The Company anticipates that it will make contributions to the Celgar Defined Benefit Plans of approximately \$871 in 2017. Estimated future benefit payments under the Celgar Defined Benefit Plans are as follows:

	<b>Pension</b>	<b>Other Post-Retirement Benefits</b>
2017	\$ 2,287	\$ 791
2018	2,300	845
2019	2,301	897
2020	2,280	947
2021	2,251	996
2022 - 2026	11,088	5,755

*Weighted Average Assumptions*

The weighted-average assumptions used to determine the benefit obligations at the measurement dates and the net benefit costs were as follows:

	<b>2016</b>	<b>December 31, 2015</b>	<b>2014</b>
Benefit obligations			
Discount rate	3.80%	4.00%	3.75%
Rate of compensation increase	2.50%	2.50%	2.50%
Net benefit cost for year ended			
Discount rate	4.00%	3.75%	4.50%
Rate of compensation increase	2.50%	2.50%	2.75%
Expected rate of return on plan assets	6.40%	6.40%	6.60%

The discount rate assumption is adjusted annually to reflect the rates available on high-quality debt instruments, with a duration that is expected to match the timing of expected pension and other post-retirement benefit obligations. High-quality debt instruments are corporate bonds with a rating of AA or better.

The expected rate of return on plan assets is a management estimate based on, among other factors, historical long-term returns, expected asset mix and active management premium.

The expected rate of compensation increase is a management estimate based on, among other factors, historical compensation increases and promotions, while considering current industry conditions, the terms of collective bargaining agreements with employees and the outlook for the industry.

Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 7. Pension and Other Post-Retirement Benefit Obligations (continued)**

The assumed health care cost trend rates used to determine the other post-retirement benefit obligations were as follows:

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
Health care cost trend rate assumed for next year	6.00%	6.50%
Rate to which the cost trend is assumed to decline to (ultimate trend rate)	4.50%	4.50%
Year that the rate reaches the ultimate trend rate	2020	2020

The expected health care cost trend rates are based on historical trends for these costs, as well as recently enacted health care legislation. The Company also compares health care cost trend rates to those of the industry.

A one-percentage point change in assumed health care cost trend rate would have the following effect on other post-retirement benefit obligations:

	<b>December 31, 2016</b>		<b>December 31, 2015</b>	
	<b>1% Increase</b>	<b>1% Decrease</b>	<b>1% Increase</b>	<b>1% Decrease</b>
Effect on total service and interest rate components	\$ 32	\$ (34)	\$ 36	\$ (39)
Effect on other post-retirement benefit obligations	\$ 578	\$ (564)	\$ 613	\$ (598)

*Investment Objective and Asset Allocation*

The investment objective for the defined benefit pension plan is to sufficiently diversify invested plan assets to maintain a reasonable level of risk without imprudently sacrificing the return on the invested funds, and ultimately to achieve a long-term total rate of return, net of fees and expenses, at least equal to the long-term interest rate assumptions used for funding actuarial valuations. To achieve this objective, the Company's overall investment strategy is to maintain an investment allocation mix of long-term growth investments (equities) and fixed income investments (debt securities). Investment allocation targets have been established by asset class after considering the nature of the liabilities, long-term return expectations, the risks associated with key asset classes, inflation and interest rates and related management fees and expenses. In addition, the defined benefit pension plan's investment strategy seeks to minimize risk beyond legislated requirements by constraining the investment managers' investment options. There are a number of specific constraints based on investment type, but they all have the general purpose of ensuring that the investments are fully diversified and that risk is appropriately managed. For example, there are constraints on the book value of assets that can be invested in any one entity or group, and all equity holdings must be listed on a

public exchange. Reviews of the investment objectives, key assumptions and the independent investment managers are performed periodically.

Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 7. Pension and Other Post-Retirement Benefit Obligations (continued)**

The target asset allocation of the defined benefit pension plan's assets, based on the fair value of the assets held, is 60% equity securities and 40% debt securities. The following table presents the defined benefit pension plan's assets fair value measurements as at December 31, 2016 under the fair value hierarchy:

Asset Category	Fair value measurements as at December 31, 2016 using:			
	Level 1	Level 2	Level 3	Total
Equity securities	\$ 20,528	\$	\$	\$ 20,528
Debt securities	12,483			12,483
<b>Total assets</b>	<b>\$ 33,011</b>	<b>\$</b>	<b>\$</b>	<b>\$ 33,011</b>

*Concentrations of Risk in the Defined Benefit Pension Plan's Assets*

The Company has reviewed the defined benefit pension plan's investments and determined that they are allocated based on the specific investment manager's stated investment strategy with only slight over- or under-weightings within any specific category, and that those investments are within the constraints that have been set by the Company. Those constraints include a limitation on the value that can be invested in any one entity or group and the investment category targets noted above. In addition, we have three independent investment managers. The Company has concluded that there are no significant concentrations of risk.

**Defined Contribution Plan**

Effective December 31, 2008, the Celgar Defined Benefit Plans were closed to new members. In addition, the defined benefit service accrual ceased on December 31, 2008, and members began to receive pension benefits, at a fixed contractual rate, under a new defined contribution plan effective January 1, 2009. During the year ended December 31, 2016, the Company made contributions of \$743 (2015 \$646; 2014 \$759), to this plan.

**Multiemployer Plan**

The Company participates in a multiemployer plan for the hourly-paid employees at the Celgar mill. The contributions to the plan are determined based on a percentage of pensionable earnings pursuant to a collective bargaining agreement. The Company has no current or future contribution obligations in excess of the contractual contributions. Contributions during the year ended December 31, 2016 totaled \$1,944 (2015 \$1,390; 2014 \$2,085). Plan details are included in the following table:



<b>Legal name</b>	<b>Provincially Registered Plan Number</b>	<b>Expiration Date of Collective Bargaining Agreement</b>	<b>Are the Company's Contributions Greater Than 5% of Total Contributions?</b>		
			<b>2016</b>	<b>2015</b>	<b>2014</b>
The Pulp and Paper Industry Pension Plan	P085324	April 30, 2017	No	No	No

Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 8. Income Taxes**

Income before provision for income taxes by taxing jurisdiction was as follows:

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
U.S.	\$ (32,511)	\$ (27,788)	\$ (55,089)
Foreign	91,975	132,739	159,281
	\$ 59,464	\$ 104,951	\$ 104,192

The net income tax benefit (provision) recognized in the Consolidated Statement of Operations for the years ended December 31, 2016, 2015 and 2014 was related to foreign tax jurisdictions.

The Company's effective income tax rate can be affected by many factors, including but not limited to, changes in the mix of earnings in tax jurisdictions with differing statutory rates, changes in corporate structure, changes in the valuation of deferred tax assets and liabilities, the result of audit examinations of previously filed tax returns and changes in tax laws. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities.

The Company and/or one or more of its subsidiaries file income tax returns in the U.S., Germany and Canada. Currently, the Company does not anticipate that the expiration of the statute of limitations or the completion of audits in the next fiscal year will result in liabilities for uncertain income tax positions that are materially different than the amounts accrued or disclosed as of December 31, 2016. However, this could change as tax years are examined by taxing authorities, the timing of those examinations, are uncertain at this time. The German tax authorities have completed examinations up to and including the 2013 tax year for all but two German entities. For one of the German entities, 2008 to 2013 tax years are being examined and for the other entity, 2011 to 2013 tax years are being examined. The Company is generally not subject to U.S. or Canadian income tax examinations for tax years before 2013 and 2012, respectively. The Company believes that it has adequately provided for any reasonable foreseeable outcomes related to its tax audits and that any settlement will not have a material adverse effect on its consolidated results.

The liability in the Consolidated Balance Sheet related to unrecognized tax benefits was \$nil as at December 31, 2016 (2015 \$nil). The Company recognizes interest and penalties related to unrecognized tax benefits in current income tax provision in the Consolidated Statement of Operations. During the year ended December 31, 2016, the Company recognized \$nil in interest and penalties (2015 \$nil; 2014 \$nil).



Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 8. Income Taxes (continued)**

Differences between the U.S. Federal Statutory and the Company's effective rates are as follows:

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
U.S. Federal statutory rate	<b>35%</b>	<b>35%</b>	<b>35%</b>
U.S. Federal statutory rate on income before provision for income taxes and noncontrolling interest	\$ (20,812)	\$ (36,972)	\$ (36,467)
Tax differential on foreign income	5,822	9,330	11,295
Effect of foreign earnings	(13,850)	(5,290)	(9,998)
Change in undistributed earnings	(13,297)		
Valuation allowance	9,188	(2,765)	52,906
Tax benefit of partnership structure	4,933	5,217	5,987
Non-taxable foreign subsidiaries	2,118	2,281	1,263
True-up of prior year taxes	(980)	5,073	
Foreign exchange on valuation allowance	632	(5,005)	(7,146)
Foreign exchange on settlement of debt	3,150		
Other	(1,425)	(1,318)	(1,066)
	\$ (24,521)	\$ (29,449)	\$ 16,774
<b>Comprised of:</b>			
Current income tax provision	\$ (7,712)	\$ (11,934)	\$ (5,242)
Deferred income tax benefit (provision)	(16,809)	(17,515)	22,016
	\$ (24,521)	\$ (29,449)	\$ 16,774

**Table of Contents****MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 8. Income Taxes (continued)**

Deferred income tax assets and liabilities are composed of the following:

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
German tax loss carryforwards	\$ 65,582	\$ 75,668
U.S. tax loss carryforwards and credits	62,202	65,957
Canadian tax loss carryforwards	2,033	217
Basis difference between income tax and financial reporting with respect to operating pulp mills	(56,723)	(58,047)
Undistributed earnings of foreign subsidiary	(13,297)	
Long-term debt	(5,996)	(6,253)
Payable and accrued expenses	3,102	7,328
Deferred pension liability	6,877	6,911
Capital leases	5,640	1,146
Research and development expense pool	2,904	3,539
Other	2,791	4,144
	75,115	100,610
Valuation allowance	(81,439)	(90,627)
Net deferred tax asset (liability)	\$ (6,324)	\$ 9,983
Comprised of:		
Deferred income tax asset	\$ 10,990	\$ 23,154
Deferred income tax liability	(17,314)	(13,171)
Net deferred tax asset (liability)	\$ (6,324)	\$ 9,983

The following table details the scheduled expiration dates of the Company's net operating loss, interest and income tax credit carryforwards as at December 31, 2016:

	<b>Amount</b>	<b>Expiration Date</b>
Germany		

Net operating loss	\$	203,800	Indefinite	
Interest	\$	121,700	Indefinite	
U.S.				
Net operating loss	\$	157,400	2025	2035
Income tax credits	\$	7,100	2020	2026
Canada				
Net operating loss	\$	7,800	2029	2036
Scientific research and experimental development tax credits	\$	3,900	2030	2035

At each reporting period, the Company assesses whether it is more likely than not that the deferred tax assets will be realized, based on the review of all available positive and negative evidence, including future reversals of existing taxable temporary differences, estimates of future taxable income, past operating

**Table of Contents****MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 8. Income Taxes (continued)**

results and prudent and feasible tax planning strategies. The carrying value of the Company's deferred tax assets reflects its expected ability to generate sufficient future taxable income in certain tax jurisdictions to utilize these deferred income tax benefits. Significant judgment is required when evaluating this positive and negative evidence.

The following table summarizes the changes in valuation allowances related to net deferred tax assets:

	<b>2016</b>	<b>2015</b>
Balance as at January 1	\$ 90,627	\$ 87,862
Additions (reversals)		
U.S.	(16,043)	11,571
Canada	6,223	(3,801)
The impact of changes in foreign exchange rates	632	(5,005)
Balance as at December 31	\$ 81,439	\$ 90,627

As at December 31, 2016, the Company has fully recognized all deferred tax assets for its German entities and has a full valuation allowance against the deferred tax assets for its U.S. or Canadian entities.

The Company has recognized a tax liability on undistributed earnings that it does not intend to be indefinitely reinvested outside the U.S. A significant portion of the Company's undistributed earnings are intended to be indefinitely reinvested in operations outside of the U.S. If these foreign earnings were to be repatriated in the future, the related U.S. tax liability may be reduced by any foreign income taxes previously paid on these earnings. In addition, the Company has loss carryforwards which may be used to offset any current tax liability.

As of December 31, 2016, the cumulative amount of earnings upon which U.S. income taxes have not been provided was approximately \$238,300. It is not practicable to estimate the income tax liability that might be incurred if such earnings were remitted to the U.S.

**Note 9. Shareholders' Equity****Dividends**

During the years ended December 31, 2016 and 2015 the Company's Board of Directors declared the following quarterly dividends:

<b>Date Declared</b>	<b>Dividend Per Common Share</b>		<b>Amount</b>
February 11, 2016	\$	0.115	\$ 7,435
April 28, 2016		0.115	7,440
July 28, 2016		0.115	7,440
October 27, 2016		0.115	7,440
	\$	0.460	\$ 29,755



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Date Declared	Dividend Per Common Share	Amount
July 30, 2015	\$ 0.115	\$ 7,418
October 29, 2015	0.115	7,418
	\$ 0.230	\$ 14,836

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

In February 2017, the Company's Board of Directors declared a quarterly dividend of \$0.115 per common share. Payment of the dividend will be made on April 4, 2017 to all shareholders of record on March 28, 2017. Future dividends are subject to approval by the Board of Directors and may be adjusted as business and industry conditions warrant.

**Share Capital***Preferred shares*

The Company has authorized 50,000,000 preferred shares (2015 = 50,000,000) with \$1 par value issuable in series, of which 2,000,000 shares have been designated as Series A. The preferred shares may be issued in one or more series. Designations and preferences for each series shall be stated in the resolutions providing for the designation and issuance of each such series adopted by the Company's Board of Directors. The Board of Directors is authorized by the Company's articles of incorporation to determine the voting, dividend, redemption and liquidation preferences pertaining to each such series. As at December 31, 2016, no preferred shares had been issued by the Company.

**Stock Based Compensation**

In June 2010, the Company adopted a stock incentive plan which provides for options, restricted stock rights, restricted shares, performance shares, PSUs and stock appreciation rights to be awarded to employees, consultants and non-employee directors. During the year ended December 31, 2016, there were no issued and outstanding options, restricted stock rights, performance shares or stock appreciation rights. As at December 31, 2016, after factoring in all allocated shares, there remain approximately 1,044,000 common shares available for grant.

*PSUs*

PSUs comprise rights to receive common shares at a future date that are contingent on the Company and the grantee achieving certain performance objectives. The performance objective period is generally three years.

For the year ended December 31, 2016, the Company recognized an expense of \$4,210 related to PSUs (2015 \$1,819; 2014 \$1,023).

Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 9. Shareholders Equity (continued)**

The following table summarizes PSU activity during the year:

	<b>Number of PSUs</b>		<b>Weighted Average Grant Date Fair Value Per Unit</b>
Outstanding as at January 1, 2016	1,255,919	\$	11.21
Granted	997,863	\$	6.04
Vested and issued	(154,242)	\$	12.92
Forfeited	(31,366)	\$	8.63
Outstanding as at December 31, 2016	2,068,174	\$	8.63

The weighted-average grant date fair value per unit of all PSUs granted in 2015 and 2014 was \$12.95 and \$9.50, respectively. The total fair value of PSUs vested and issued in 2016, 2015 and 2014 was \$1,382, \$2,031 and \$3,046, respectively.

*Restricted Shares*

Restricted shares generally vest at the end of one year; however, 200,000 restricted shares granted during the year ended December 31, 2011 vested in equal amounts over a five-year period commencing in 2012.

Expense recognized for the year ended December 31, 2016 was \$449 (2015 \$590; 2014 \$563). As at December 31, 2016, the total remaining unrecognized compensation cost related to restricted shares amounted to approximately \$153 which will be amortized over the remaining vesting periods.

The following table summarizes restricted share activity during the year:

	<b>Number of Restricted Shares</b>		<b>Weighted Average Grant Date Fair Value Per Share</b>
Outstanding as at January 1, 2016	78,000	\$	13.65
Granted	38,000	\$	9.41

Vested and issued	(78,000)	\$	13.65
Outstanding as at December 31, 2016	38,000	\$	9.41

The weighted-average grant date fair value per share of all restricted shares granted in 2015 and 2014 was \$14.48 and \$8.85, respectively. The total fair value of restricted shares vested and issued in 2016, 2015 and 2014 was \$697, \$1,096 and \$670, respectively.

Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 10. Net Income Per Share Attributable to Common Shareholders**

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net income attributable to common shareholders			
Basic and diluted	\$ 34,943	\$ 75,502	\$ 113,154
Net income per share attributable to common shareholders			
Basic	\$ 0.54	\$ 1.17	\$ 1.82
Diluted	\$ 0.54	\$ 1.17	\$ 1.81
Weighted average number of common shares outstanding:			
Basic <sup>(1)</sup>	64,631,491	64,380,565	62,012,947
Effect of dilutive shares:			
PSUs	447,465	335,922	406,922
Restricted shares	19,309	56,453	79,889
Stock options		3,852	15,112
Diluted	65,098,265	64,776,792	62,514,870

(1) For the year ended December 31, 2016, the basic weighted average number of common shares outstanding excludes 38,000 restricted shares which have been issued, but have not vested as at December 31, 2016 (2015 78,000 restricted shares; 2014 118,000 restricted shares).

The calculation of diluted net income per share attributable to common shareholders does not assume the exercise of any instruments that would have an anti-dilutive effect on net income per share attributable to common shareholders. There were no anti-dilutive instruments for the years ended December 31, 2016, 2015 and 2014.

Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 11. Accumulated Other Comprehensive Loss**

The components of accumulated other comprehensive loss are as follows:

	<b>Foreign Currency Translation Adjustment</b>	<b>Defined Benefit Pension and Other Post- Retirement Benefit Items</b>	<b>Unrealized Gains / Losses on Marketable Securities</b>	<b>Total</b>
Balance as at December 31, 2014	\$ (33,268)	\$ (19,287)	\$ 114	\$ (52,441)
Other comprehensive income (loss) before reclassifications	(122,955)	3,063	(127)	(120,019)
Amounts reclassified from accumulated other comprehensive loss		886		886
Other comprehensive income (loss), net of taxes	(122,955)	3,949	(127)	(119,133)
Balance as at December 31, 2015	(156,223)	(15,338)	(13)	(171,574)
Other comprehensive loss before reclassifications	(14,369)	(342)	(1)	(14,712)
Amounts reclassified from accumulated other comprehensive loss		1,017		1,017
Other comprehensive income (loss), net of taxes	(14,369)	675	(1)	(13,695)
Balance as at December 31, 2016	\$ (170,592)	\$ (14,663)	\$ (14)	\$ (185,269)

**Note 12. Business Segment Information**

The Company has three operating segments, the individual pulp mills that are aggregated into one reportable business segment, market pulp, due to the similar economic characteristics of the mills. Accordingly, the results presented are those of the one reportable business segment.



Table of Contents**MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 12. Business Segment Information (continued)**

The following table presents net sales to external customers by product and by geographic area based on location of the customer:

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Pulp revenues</b>			
Germany	\$ 326,898	\$ 344,843	\$ 346,879
China	221,773	266,632	276,848
Other European Union countries <sup>(1)</sup>	173,585	210,218	250,952
Italy	53,702	53,919	80,730
Other Asia	31,897	43,981	69,711
U.S.	26,985	15,453	39,146
Other countries	12,488	11,191	9,366
	<b>847,328</b>	<b>946,237</b>	<b>1,073,632</b>
<b>Energy and chemical revenues</b>			
Germany	74,904	75,776	91,375
Canada	9,391	11,191	10,105
	<b>\$ 931,623</b>	<b>\$ 1,033,204</b>	<b>\$ 1,175,112</b>

(1) Not including Germany or Italy.

The following table presents total long-lived assets by geographic area based on location of the asset:

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
Germany	\$ 593,237	\$ 623,932
Canada	145,039	138,459
	<b>\$ 738,276</b>	<b>\$ 762,391</b>

In 2016, two customers through several of their operations accounted for 19% and 10%, respectively, of the Company's total pulp revenues (2015 – one customer through several of its operations accounted for 16%; 2014 – one customer through several of their operations accounted for 13%).



**Note 13. Derivative Transactions**

The Company is exposed to certain market risks relating to its ongoing business. The Company seeks to manage these risks through internal risk management policies as well as, from time to time, the use of derivatives. The derivatives are measured at fair value with changes in fair value immediately recognized in gain (loss) on derivative instruments in the Consolidated Statement of Operations.

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**MERCER INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

**Note 13. Derivative Transactions (continued)**

**Interest Rate Swaps**

During 2002, the Company entered into certain variable-to-fixed interest rate swaps in connection with the Stendal mill with respect to an aggregate maximum amount of approximately 612.6 million of the principal amount of the indebtedness under the Stendal mill's senior project finance facility, which was settled in November 2014. Under the remaining interest rate swaps, the Company pays a fixed rate and receives a floating rate with the derivative payments being calculated on a notional amount. As at December 31, 2016, the contract has a fair value of 6.2 million (\$6,522; 2015 \$16,913) of which 6.2 million (\$6,522; 2015 \$10,380) was classified as current within accounts payable and other and \$nil (2015 \$6,533) was classified as a long-term liability in the Consolidated Balance Sheet. The contract has an aggregate notional amount of 128.3 million, a fixed interest rate of 5.28% and matures in October 2017.

The Company has pledged as collateral cash in the amount of 67% of the fair value of the interest rate swap up to 8.5 million to the derivative counterparty. The calculation to determine the collateral is performed semi-annually, with the final calculation in October 2017. As at December 31, 2016, the collateral was 4.1 million (\$4,327; 2015 \$9,230). This cash has been classified as restricted cash in the Consolidated Balance Sheet.

The counterparty to the interest rate derivative is a bank that is a member of a banking syndicate that holds the Stendal 75.0 million revolving credit facility and the Company does not anticipate non-performance by the bank.

**Credit Risk**

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

The carrying amount of cash and cash equivalents of \$136,569, restricted cash of \$4,327 and accounts receivable of \$123,892 recorded in the Consolidated Balance Sheet, net of any allowances for losses, represents the Company's maximum exposure to credit risk.

**Note 14. Fair Value Measurement and Disclosure**

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

The fair value of the interest rate derivative liability classified as Level 2 was determined using a discounted cash flow model that uses as its basis readily observable market inputs, such as forward interest rates and yield curves observable at specified intervals. The observable inputs reflect market data obtained from independent sources, including the Euribor rate provided by the counterparty to the interest rate derivative.

**Table of Contents****MERCER INTERNATIONAL INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(In thousands of U.S. dollars, except share and per share data)****Note 14. Fair Value Measurement and Disclosure (continued)**

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

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

Description	Fair value measurements as at December 31, 2016 using:			
	Level 1	Level 2	Level 3	Total
Interest rate derivative liability	\$	\$ 6,522	\$	\$ 6,522
Senior Notes debt		654,378		654,378
	\$	\$ 660,900	\$	\$ 660,900

Description	Fair value measurements as at December 31, 2015 using:			
	Level 1	Level 2	Level 3	Total
Interest rate derivative liability	\$	\$ 16,913	\$	\$ 16,913
Senior Notes debt		654,625		654,625
	\$	\$ 671,538	\$	\$ 671,538

**Note 15. Lease Commitments**

Minimum lease payments, primarily for various vehicles, and plant and equipment under capital and non-cancellable operating leases and the present value of net minimum payments as at December 31, 2016 are as follows:

	Capital Leases	Operating Leases
2017	\$ 3,908	\$ 1,666
2018	3,270	1,323
2019	4,220	1,293
2020	1,980	1,102
2021	1,887	
Thereafter	12,208	

Total	27,473	\$	5,384
Less: imputed interest	4,799		
Total present value of minimum capitalized payments	22,674		
Less: current portion of capital lease obligations	3,066		
Long-term capital lease obligations	\$	19,608	

The current portion of the capital lease obligations was included in accounts payable and other and the long-term portion was included in capital leases and other in the Consolidated Balance Sheet. Rent expense under operating leases was \$1,393 for the year ended December 31, 2016 (2015 \$2,271; 2014 \$2,978).

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**MERCER INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

**Note 16. Commitments and Contingencies**

- (a) The Company is involved in legal actions and claims arising in the ordinary course of business. While the outcome of any legal actions and claims cannot be predicted with certainty, it is the opinion of management that the outcome of any such claims which are pending or threatened, either individually or on a combined basis, will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company.
- (b) The Company is subject to regulations that require the handling and disposal of asbestos in a prescribed manner if a property undergoes a major renovation or demolition. Otherwise, the Company is not required to remove asbestos from its facilities. Generally asbestos is found on steam and condensate piping systems as well as certain cladding on buildings and in building insulation throughout older facilities. The Company's obligation for the proper removal and disposal of asbestos products from the Company's mills is a conditional asset retirement obligation. As a result of the longevity of the Company's mills, due in part to the maintenance procedures and the fact that the Company does not have plans for major changes that require the removal of asbestos, the timing of the asbestos removal is indeterminate. As a result, the Company is currently unable to reasonably estimate the fair value of its asbestos removal and disposal obligation. The Company will recognize a liability in the period in which sufficient information is available to reasonably estimate its fair value.

**Table of Contents****SUPPLEMENTARY FINANCIAL INFORMATION****(UNAUDITED)****Selected Quarterly Financial Data****(In thousands of U.S. dollars, except per share data)**

	<b>Quarters Ended</b>			
	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
<b>2016</b>				
Revenues	\$ 253,843	\$ 218,145	\$ 237,941	\$ 221,694
Gross profit	28,100	16,777	29,821	39,045
Net income (loss) attributable to common shareholders	8,769	(4,241)	11,926	18,489
Net income (loss) per share attributable to common shareholders*	\$ 0.14	\$ (0.07)	\$ 0.18	\$ 0.28
<b>2015</b>				
Revenues	\$ 257,547	\$ 266,936	\$ 270,893	\$ 237,828
Gross profit	43,931	33,549	44,032	44,172
Net income (loss) attributable to common shareholders	13,634	16,412	23,760	21,696
Net income (loss) per share attributable to common shareholders*	\$ 0.21	\$ 0.25	\$ 0.37	\$ 0.33

\* On a diluted basis

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**MERCER INTERNATIONAL INC.**

Dated: February 10, 2017

By: /s/ JIMMY S.H. LEE  
Jimmy S.H. Lee  
Executive Chairman

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ JIMMY S.H. LEE  
Jimmy S.H. Lee  
Executive Chairman and Director

Date: February 10, 2017

/s/ DAVID M. GANDOSSO  
David M. Gandossi  
Chief Executive Officer and Director

Date: February 10, 2017

/s/ DAVID K. URE  
David K. Ure  
Executive Vice President,  
Chief Financial Officer and Principal  
Accounting Officer

Date: February 10, 2017

/s/ ERIC LAURITZEN  
Eric Lauritzen  
Director

Date: February 10, 2017

/s/ WILLIAM D. MCCARTNEY  
William D. McCartney  
Director

Date: February 10, 2017

/s/ GRAEME A. WITTS  
Graeme A. Witts  
Director

Date: February 10, 2017

/s/ BERNARD PICCHI  
Bernard Picchi  
Director

Date: February 10, 2017

/s/ JAMES SHEPHERD

Date: February 10, 2017



James Shepherd  
Director

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/s/ KEITH PURCHASE  
Keith Purchase  
Director

Date: February 10, 2017

/s/ NANCY ORR  
Nancy Orr  
Director

Date: February 10, 2017

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<b>Exhibit No.</b>	<b>Description of Exhibit</b>
2.1	Agreement and Plan of Merger among Mercer International Inc., Mercer International Regco Inc. and Mercer Delaware Inc. dated December 14, 2005. Incorporated by reference to the Proxy Statement/Prospectus filed on December 15, 2005.
3.1	Articles of Incorporation of Mercer International Inc., as amended. Incorporated by reference from Form 8-A filed March 2, 2006.
3.2	Bylaws of Mercer International Inc. Incorporated by reference from Form 8-A filed March 2, 2006.
4.1	Indenture dated November 26, 2014 between Mercer International Inc. and Wells Fargo Bank, National Association, as trustee, relating to the 2019 Senior Notes. Incorporated by reference from Form 8-K filed November 28, 2014.
4.2	Indenture dated November 26, 2014 between Mercer International Inc. and Wells Fargo Bank, National Association, as trustee, relating to the 2022 Senior Notes. Incorporated by reference from Form 8-K filed November 28, 2014.
4.3	Indenture dated February 3, 2017 between Mercer International Inc. and Wells Fargo Bank, National Association, as trustee, relating to the 2024 Senior Notes. Incorporated by reference from Form 8-K filed February 3, 2017.
10.1	Revolving Credit Facility Agreement dated November 25, 2014 among Zellstoff Stendal GmbH, UniCredit Bank AG, Credit Suisse AG, London Branch, Royal Bank of Canada and Barclays Bank PLC. Incorporated by reference from Form 8-K filed November 28, 2014.
10.2	Form of Trustee's Indemnity Agreement between Mercer International Inc. and its Trustees. Incorporated by reference from Form 10-K filed March 31, 2003.
10.3	2004 Stock Incentive Plan. Incorporated by reference from Form S-8 filed June 16, 2004.
10.4	Mercer International Inc. 2010 Stock Incentive Plan. Incorporated by reference from Appendix A to Mercer International Inc.'s definitive proxy statement on Schedule 14A filed April 24, 2014.
10.5	Employment Agreement effective September 1, 2005 between Mercer International Inc. and Leonhard Nossol dated August 18, 2005. Incorporated by reference from Form 10-Q filed May 6, 2008.
10.6	Employment Agreement dated October 20, 2005 between Mercer Pulp Sales GmbH and David Cooper. Incorporated by reference from Form 10-Q filed April 29, 2015.
10.7	Employment Agreement dated October 2, 2006 between Stendal Pulp Holding GmbH and Wolfram Ridder. Incorporated by reference from Form 8-K filed October 3, 2006.
10.8	Electricity Purchase Agreement effective January 27, 2009 between Zellstoff Celgar Limited Partnership and British Columbia Hydro and Power Authority. Incorporated by reference from Form 10-K filed March 2, 2009. Certain non-public information has been omitted from the appendices to Exhibit 10.9 pursuant to a request for confidential treatment filed with the

SEC. Such non-public information was filed with the SEC on a confidential basis. The SEC approved the request for confidential treatment in March 2009.

10.9 Revolving Credit Facility Agreement dated August 19, 2009 among D&Z Holding GmbH, Zellstoff-und Papierfabrik Rosenthal GmbH, D&Z Beteiligungs GmbH and ZPR Logistik GmbH and Bayerische Hypo-und Vereinsbank AG. Incorporated by reference from Form 8-K filed August 24, 2009.

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<b>Exhibit No.</b>	<b>Description of Exhibit</b>
10.10	Extension, Amendment and Confirmation Letter dated October 4, 2012 among Zellstoff- und Papierfabrik Rosenthal GmbH, D&Z Holding GmbH, D&Z Beteiligungs GmbH, ZPR Logistik GmbH, Bayerische Hypo-und Vereinsbank AG and Mercer International Inc. Incorporated by reference from Form 10-Q filed November 2, 2012.
10.11	Second Amended and Restated Credit Agreement dated as of May 2, 2013 among Zellstoff Celgar Limited Partnership, as borrower, and the lenders from time to time parties thereto, as lenders, and Canadian Imperial Bank of Commerce, as agent. Incorporated by reference from Form 8-K filed May 8, 2013.
10.12	Second Extension, Amendment and Confirmation Letter dated February 5, 2016 among Zellstoff- und Papierfabrik Rosenthal GmbH, D&Z Holding GmbH, ZPR Logistik GmbH and Mercer International Inc. Incorporated by reference from Form 10-K filed February 12, 2016.
10.13	Employment Agreement between Mercer International Inc. and David Ure dated August 12, 2013. Incorporated by reference from Form 8-K filed on July 19, 2015.
10.14	First Amending Agreement dated October 21, 2014 between Zellstoff Celgar Limited Partnership, Mercer International Inc., as guarantor, and Canadian Imperial Bank of Commerce. Incorporated by reference from Form 10-Q filed October 31, 2014.
10.15	Amendment to Employment Agreement between Mercer International Inc. and David Ure, dated July 17, 2015. Incorporated by reference from Form 8-K filed July 19, 2015.
10.16	Second Amended and Restated Employment Agreement between Mercer International Inc. and Jimmy S.H. Lee, dated for reference September 29, 2015. Incorporated by reference from Form 8-K filed September 28, 2015.
10.17	Amended and Restated Employment Agreement between Mercer International Inc. and David M. Gandossi, dated for reference September 29, 2015. Incorporated by reference from Form 8-K filed September 28, 2015.
10.18	Registration Rights Agreement dated February 3, 2017 between Mercer International Inc. and Credit Suisse Securities (USA) LLC, related to the 2024 Senior Notes. Incorporated by reference from Form 8-K filed on February 3, 2017.
14.1	Code of Business Conduct and Ethics. Incorporated by reference from Mercer International Inc.'s definitive proxy statement on Schedule 14A filed August 11, 2003.
21.1*	List of Subsidiaries of Registrant.
23.1*	Consent of PricewaterhouseCoopers LLP.
31.1*	Section 302 Certificate of Chief Executive Officer.
31.2*	Section 302 Certificate of Chief Financial Officer.
32.1*	Section 906 Certificate of Chief Executive Officer.
32.2*	Section 906 Certificate of Chief Financial Officer.
101*	The following financial statements from the Company's annual report on Form 10-K for the year ended December 31, 2016, filed with the SEC on February 10, 2017, formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Statements of Operations; (ii) Consolidated Statements of Comprehensive Income (Loss); (iii) Consolidated Balance

Sheets; (iv) Consolidated Statements of Changes in Shareholders' Equity; (v) Consolidated Statements of Cash Flows; and (vi) Notes to the Consolidated Financial Statements.

\* Filed herewith.

Denotes management contract or compensatory plan or arrangement.