

ARCH COAL INC  
Form 10-Q  
May 04, 2011

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

**FORM 10-Q**

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended March 31, 2011**

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

**Commission file number: 1-13105**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction  
of incorporation or organization)

**43-0921172**

(I.R.S. Employer  
Identification Number)

**One CityPlace Drive, Suite 300, St. Louis, Missouri**

(Address of principal executive offices)

**63141**

(Zip code)

Registrant's telephone number, including area code: (314) 994-2700

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer 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 Exchange Act). Yes  No

At May 2, 2011 there were 164,346,773 shares of the registrant's common stock outstanding.

**Table of Contents**

	Page
<u>Part I FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	1
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	25
<u>Item 4. Controls and Procedures</u>	26
<u>Part II OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	26
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	28
<u>Item 3. Defaults Upon Senior Securities</u>	28
<u>Item 4. Reserved</u>	28
<u>Item 5. Other Information</u>	28
<u>Item 6. Exhibits</u>	30
<u>EX-12.1</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	

**Table of Contents**

Part I  
 FINANCIAL INFORMATION  
 Item 1. Financial Statements.

**Arch Coal, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Income**  
 (in thousands, except per share data)

	<b>Three Months Ended March</b>	
	<b>31</b>	
	<b>2011</b>	<b>2010</b>
	(unaudited)	
<b>REVENUES</b>		
Coal sales	\$ 872,938	\$ 711,874
<b>COSTS, EXPENSES AND OTHER</b>		
Cost of coal sales	653,684	550,750
Depreciation, depletion and amortization	83,537	88,519
Amortization of acquired sales contracts, net	5,944	10,753
Selling, general and administrative expenses	30,435	27,166
Change in fair value of coal derivatives and coal trading activities, net	(1,784)	5,877
Other operating income, net	(1,116)	(3,391)
	770,700	679,674
Income from operations	102,238	32,200
Interest expense, net:		
Interest expense	(34,580)	(35,083)
Interest income	746	338
	(33,834)	(34,745)
Income (loss) before income taxes	68,404	(2,545)
Provision for (benefit from) income taxes	12,530	(775)
Net income (loss)	55,874	(1,770)
Less: Net income attributable to noncontrolling interest	(273)	(26)
Net income (loss) attributable to Arch Coal, Inc.	\$ 55,601	\$ (1,796)
<b>EARNINGS (LOSS) PER COMMON SHARE</b>		
Basic earnings (loss) per common share	\$ 0.34	\$ (0.01)
Diluted earnings (loss) per common share	\$ 0.34	\$ (0.01)
Basic weighted average shares outstanding	162,576	162,372
Diluted weighted average shares outstanding	163,773	162,372

Edgar Filing: ARCH COAL INC - Form 10-Q

Dividends declared per common share	\$	0.10	\$	0.09
-------------------------------------	----	------	----	------

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

1

---

**Table of Contents**

**Arch Coal, Inc. and Subsidiaries**  
**Condensed Consolidated Balance Sheets**  
(in thousands, except per share data)

	<b>March 31,</b>	<b>December</b>
	<b>2011</b>	<b>31,</b>
	(unaudited)	
		<b>2010</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 69,220	\$ 93,593
Trade accounts receivable	258,499	208,060
Other receivables	44,818	44,260
Inventories	247,908	235,616
Prepaid royalties	42,719	33,932
Deferred income taxes	18,673	
Coal derivative assets	15,952	15,191
Other	101,153	104,262
Total current assets	798,942	734,914
Property, plant and equipment, net	3,263,555	3,308,892
Other assets:		
Prepaid royalties	69,737	66,525
Goodwill	114,963	114,963
Deferred income taxes	331,242	361,556
Equity investments	204,424	177,451
Other	117,115	116,468
Total other assets	837,481	836,963
Total assets	\$ 4,899,978	\$ 4,880,769
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 183,866	\$ 198,216
Coal derivative liabilities	4,178	4,947
Deferred income taxes		7,775
Accrued expenses and other current liabilities	228,165	245,411
Current maturities of debt and short-term borrowings	69,518	70,997
Total current liabilities	485,727	527,346
Long-term debt	1,539,028	1,538,744
Asset retirement obligations	336,975	334,257
Accrued pension benefits	38,808	49,154
Accrued postretirement benefits other than pension	36,920	37,793

Edgar Filing: ARCH COAL INC - Form 10-Q

Accrued workers' compensation	35,964	35,290
Other noncurrent liabilities	124,243	110,234
Total liabilities	2,597,665	2,632,818
Redeemable noncontrolling interest	10,718	10,444
Stockholders' equity:		
Common stock, \$0.01 par value, authorized 260,000 shares, issued 164,310 shares and 164,117 shares, respectively	1,647	1,645
Paid-in capital	1,740,765	1,734,709
Treasury stock, 1,512 shares at March 31, 2011 and December 31, 2010, at cost	(53,848)	(53,848)
Retained earnings	600,751	561,418
Accumulated other comprehensive income (loss)	2,280	(6,417)
Total stockholders' equity	2,291,595	2,237,507
Total liabilities and stockholders' equity	\$ 4,899,978	\$ 4,880,769

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

**Table of Contents**

**Arch Coal, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Cash Flows**  
(in thousands)

	<b>Three Months Ended March</b>	
	<b>2011</b>	<b>2010</b>
	(unaudited)	
<b>OPERATING ACTIVITIES</b>		
Net income (loss)	\$ 55,874	\$ (1,770)
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, depletion and amortization	83,537	88,519
Amortization of acquired sales contracts, net	5,944	10,753
Prepaid royalties expensed	8,916	6,599
Employee stock-based compensation	5,290	3,684
Amortization of debt financing costs	2,442	2,461
Changes in:		
Receivables	(53,586)	(37,013)
Inventories	(12,292)	(2,382)
Coal derivative assets and liabilities	(1,087)	5,547
Accounts payable, accrued expenses and other current liabilities	(31,596)	(6,844)
Deferred income taxes	(1,026)	150
Other	23,729	23,627
 Cash provided by operating activities	 86,145	 93,331
 <b>INVESTING ACTIVITIES</b>		
Capital expenditures	(38,711)	(31,975)
Proceeds from dispositions of property, plant and equipment	516	95
Purchases of investments and advances to affiliates	(34,419)	(10,071)
Additions to prepaid royalties	(20,915)	(23,340)
 Cash used in investing activities	 (93,529)	 (65,291)
 <b>FINANCING ACTIVITIES</b>		
Net increase (decrease) in borrowings under lines of credit and commercial paper program	3,681	(19,324)
Net payments on other debt	(5,161)	(4,742)
Debt financing costs	(8)	(200)
Dividends paid	(16,269)	(14,623)
Issuance of common stock under incentive plans	768	85
 Cash used in financing activities	 (16,989)	 (38,804)



Edgar Filing: ARCH COAL INC - Form 10-Q

Decrease in cash and cash equivalents	(24,373)	(10,764)
Cash and cash equivalents, beginning of period	93,593	61,138
Cash and cash equivalents, end of period	\$ 69,220	\$ 50,374

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

3

---

**Table of Contents**

**Arch Coal, Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements include the accounts of Arch Coal, Inc. and its subsidiaries and controlled entities (the Company). The Company's primary business is the production of steam and metallurgical coal from surface and underground mines located throughout the United States, for sale to utility, industrial and export markets. The Company's mines are located in southern West Virginia, eastern Kentucky, Virginia, Wyoming, Colorado and Utah. All subsidiaries (except as noted below) are wholly-owned. Intercompany transactions and accounts have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial reporting and U.S. Securities and Exchange Commission regulations. In the opinion of management, all adjustments, consisting of normal, recurring accruals considered necessary for a fair presentation, have been included. Results of operations for the three months ended March 31, 2011 are not necessarily indicative of results to be expected for the year ending December 31, 2011. These financial statements should be read in conjunction with the audited financial statements and related notes as of and for the year ended December 31, 2010 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission.

The Company owns a 99% membership interest in a joint venture named Arch Western Resources, LLC (Arch Western) which operates coal mines in Wyoming, Colorado and Utah. The Company also acts as the managing member of Arch Western.

**2. Accounting Policies**

In January 2011, new fair value disclosure guidance regarding activity in Level 3 fair value measurements became effective. The new disclosure guidance requires entities to provide a gross basis rollforward of the Level 3 activity. The required disclosure is provided in Note 7, Fair Value Measurements. The new guidance did not have an impact on the Company's condensed consolidated financial statements.

**3. Investments**

	<b>Knight Hawk</b>	<b>DKRW</b>	<b>DTA</b>	<b>Tenaska</b>	<b>Millennium</b>	<b>Total</b>
	<b>(In thousands)</b>					
Balance at December 31, 2010	\$ 131,250	\$ 21,961	\$ 14,472	\$ 9,768	\$	\$ 177,451
Investments in affiliates				5,500	25,000	30,500
Advances to (distributions from) affiliates, net	(7,533)		1,312			(6,221)
Equity in comprehensive income (loss)	4,661	(511)	(1,130)		(326)	2,694
Balance at March 31, 2011	\$ 128,378	\$ 21,450	\$ 14,654	\$ 15,268	\$ 24,674	\$ 204,424

The Company holds a 49% ownership interest in Knight Hawk Holdings, LLC (Knight Hawk), a coal producer in the Illinois Basin. Of the distribution declared in the first quarter of 2011, the Company received \$1.5 million in the first quarter and the remaining balance will be paid in the second quarter of 2011.

The Company holds a 24% ownership interest in DKRW Advanced Fuels LLC (DKRW), a company engaged in developing coal-to-liquids facilities. Under a coal reserve purchase option, DKRW could purchase reserves from the Company, which the Company would then mine on a contract basis for DKRW. Under a convertible secured promissory note, the Company had advanced to DKRW \$22.5 million and \$18.1 million at March 31, 2011 and December 31, 2010, respectively, including unpaid interest. Amounts borrowed are due and payable in cash or in

additional equity interests on the earlier of December 31, 2011 or upon the closing of DKRW's next financing, bear interest at the rate of 1.25% per month, and are secured by DKRW's equity interests in Medicine Bow Fuel & Power LLC. The note balances are reflected in other receivables on the condensed consolidated balance sheets. As of March 31, 2011, DKRW may borrow up to an additional \$1.25 million in principal from the Company under the note.

The Company holds a general partnership interest in Dominion Terminal Associates (DTA), of 21.875%. DTA operates a ground storage-to-vessel coal transloading facility in Newport News, Virginia for use by the partners. Under the terms of a throughput and handling agreement with DTA, each partner is charged its share of cash operating and debt-

**Table of Contents**

service costs in exchange for the right to use the facility's loading capacity and is required to make periodic cash advances to DTA to fund such costs.

The Company holds a 35% ownership interest in Tenaska Trailblazer Partners, LLC ( Tenaska ), the developer of the Trailblazer Energy Center, a fossil-fuel-based electric power plant near Sweetwater, Texas. The plant, fueled by low sulfur coal, will capture and store carbon dioxide for enhanced oil recovery applications. Additional payments will be due under the investment agreement when certain project milestones are met. The Company will also pay 35% of the future development costs of the project, not to exceed \$12.5 million without prior approval from the Company. As of March 31, 2011 and December 31, 2010, the Company had advanced a total of \$4.3 million and \$4.1 million, respectively, for development costs. A receivable for these development costs is reflected in the condensed consolidated balance sheets in other noncurrent assets, as the development costs will either be reimbursed when the project receives construction financing, or they will be considered an additional capital contribution, with ownership percentages adjusted accordingly.

In January 2011, the Company purchased a 38% ownership interest in Millennium Bulk Terminals-Longview, LLC ( Millennium ), the owner of a brownfield bulk commodity terminal on the Columbia River near Longview, Washington, for \$25.0 million, plus additional future consideration upon the completion of certain project milestones. Millennium continues to work on obtaining the required approvals and necessary permits to complete dredging and other upgrades to enable coal, alumina and cementitious material shipments through the terminal. The Company will control 38% of the terminal's throughput and storage capacity, in order to facilitate export shipments of coal off the west coast of the United States.

Future contingent payments of up to \$72.4 million related to development financing for certain of our equity investees, as noted above. Our obligation to make these payments, as well as the timing of any payments required, is contingent upon a number of factors, including project development progress, receipt of permits and the obtaining of construction financing.

**4. Derivatives**

The Company generally utilizes derivative financial instruments to manage exposures to commodity prices. Additionally, the Company may hold certain coal derivative financial instruments for trading purposes.

All derivative financial instruments are recognized in the balance sheet at fair value. In a fair value hedge, the Company hedges the risk of changes in the fair value of a firm commitment, typically a fixed-price coal sales contract. Changes in both the hedged firm commitment and the fair value of a derivative used as a hedge instrument in a fair value hedge are recorded in earnings. In a cash flow hedge, the Company hedges the risk of changes in future cash flows related to a forecasted purchase or sale. Changes in the fair value of the derivative instrument used as a hedge instrument in a cash flow hedge are recorded in other comprehensive income. Amounts in other comprehensive income are reclassified to earnings when the hedged transaction affects earnings and are classified in a manner consistent with the transaction being hedged. The Company formally documents the relationships between hedging instruments and the respective hedged items, as well as its risk management objectives for hedge transactions.

The Company evaluates the effectiveness of its hedging relationships both at the hedge's inception and on an ongoing basis. Any ineffective portion of the change in fair value of a derivative instrument used as a hedge instrument in a fair value or cash flow hedge is recognized immediately in earnings. The ineffective portion is based on the extent to which exact offset is not achieved between the change in fair value of the hedge instrument and the cumulative change in expected future cash flows on the hedged transaction from inception of the hedge in a cash flow hedge or the change in the fair value of the firm commitment in a fair value hedge.

*Diesel fuel price risk management*

The Company is exposed to price risk with respect to diesel fuel purchased for use in its operations. The Company purchases approximately 55 million to 65 million gallons of diesel fuel annually in its operations. To reduce the volatility in the price of diesel fuel for its operations, the Company uses forward physical diesel purchase contracts, as well as heating oil swaps and purchased call options. At March 31, 2011, the Company had protected the price of approximately 63% of its remaining expected purchases for fiscal year 2011 and 5% for fiscal year 2012.

At March 31, 2011, the Company held heating oil swaps and purchased call options for approximately 31.7 million gallons for the purpose of managing the price risk associated with future diesel purchases. Since the changes in the

price of heating oil highly correlate to changes in the price of the hedged diesel fuel purchases, the heating oil swaps and purchased call options qualify for cash flow hedge accounting.

5

---

**Table of Contents***Coal risk management positions*

The Company may sell or purchase forward contracts, swaps and options in the over-the-counter coal market in order to manage its exposure to coal prices. The Company has exposure to the risk of fluctuating coal prices related to forecasted sales or purchases of coal or to the risk of changes in the fair value of a fixed price physical sales contract. Certain derivative contracts may be designated as hedges of these risks.

At March 31, 2011, the Company held derivatives for risk management purposes totaling 1.3 million tons of coal sales and 0.3 million tons of coal purchases that are expected to settle during the remainder of 2011 and 2.6 million tons of coal sales and 0.1 million tons of coal purchases that are expected to settle in 2012 through 2014.

*Coal trading positions*

The Company may sell or purchase forward contracts, swaps and options in the over-the-counter coal market for trading purposes. The Company is exposed to the risk of changes in coal prices on the value of its coal trading portfolio. The timing of the estimated future realization of the value of the trading portfolio is 47% for the remainder of 2011, 49% in 2012 and 4% in 2013.

*Tabular derivatives disclosures*

The Company's contracts with certain of its counterparties allow for the settlement of contracts in an asset position with contracts in a liability position in the event of default or termination. Such netting arrangements reduce the Company's credit exposure related to these counterparties. For classification purposes, the Company records the net fair value of all the positions with a given counterparty as a net asset or liability in the condensed consolidated balance sheets. The amounts shown in the table below represent the fair value position of individual contracts, regardless of the net position presented in the accompanying condensed consolidated balance sheets. The fair value and location of derivatives reflected in the accompanying condensed consolidated balance sheets are as follows:

**Fair Value of Derivatives  
(in thousands)**

	March 31, 2011		December 31, 2010			
	Asset Derivatives	Liability Derivatives	Asset Derivatives	Liability Derivatives		
<b>Derivatives Designated as Hedging Instruments</b>						
Heating oil	\$ 23,926	\$	\$ 13,475	\$		
Coal	2,193	(2,100)	2,009	(2,350)		
Total	26,119	(2,100)	15,484	(2,350)		
<b>Derivatives Not Designated as Hedging Instruments</b>						
Coal held for trading purposes	27,083	(14,584)	34,445	(24,087)		
Coal	354	(1,172)	1,139	(912)		
Total	27,437	(15,756)	35,584	(24,999)		
Total derivatives	53,556	(17,856)	51,068	(27,349)		
Effect of counterparty netting	(13,678)	13,678	(22,402)	22,402		
<b>Net derivatives as classified in the balance sheets</b>	<b>\$ 39,878</b>	<b>\$ (4,178)</b>	<b>\$ 35,700</b>	<b>\$ 28,666</b>	<b>\$ (4,947)</b>	<b>\$ 23,719</b>

**Net derivatives as reflected on the balance sheets**

		<b>March 31, 2011</b>	<b>December 31, 2010</b>
<b>Heating oil</b>	Other current assets	\$ 23,926	\$ 13,475
<b>Coal</b>	Coal derivative assets	15,952	15,191
	Coal derivative liabilities	(4,178)	(4,947)
		<b>\$ 35,700</b>	<b>\$ 23,719</b>

The Company had a current asset for the right to reclaim cash collateral of \$9.2 million and \$10.3 million at March 31,

**Table of Contents**

2011 and December 31, 2010, respectively. These amounts are not included with the derivatives presented in the table above and are included in other current assets in the accompanying condensed consolidated balance sheets.

The effects of derivatives on measures of financial performance are as follows:

**Three Months Ended March 31**  
(in thousands)

Derivatives used in	Gains (Losses)				Gain (Loss) Recognized in Income (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
	Gain (Loss) Recognized in OCI		Reclassified from OCI into Income		Amount Excluded from Effectiveness Testing	
	(Effective Portion)		(Effective Portion)		2011	2010
	2011	2010	2011	2010	2011	2010
Cash Flow Hedging Relationships						
Heating oil	\$ 14,258	\$ 12	\$ 3,170	2	\$ (2,229)	2
Coal sales	1,406	(401)	87	1	(129)	1
Coal purchases	(876)	902		2	(336)	2
Totals	\$ 14,788	\$ 513	\$ 3,257		\$ (2,694)	

**Derivatives Not Designated as Hedging Instruments**

	Gain (Loss)			
	2011	2010	2011	2010
Coal unrealized	\$ (1,045)	3	\$ (4,922)	3
Coal realized	\$	4	\$ 1,600	4

**Location in Statement of Income:**

- 1- Coal sales
- 2- Cost of coal sales
- 3- Change in fair value of coal derivatives and coal trading activities, net
- 4- Other operating income, net

The Company recognized net unrealized and realized gains of \$2.8 million during the three months ended March 31, 2011 and net unrealized and realized losses of \$1.0 million during the three months ended March 31, 2010, related to its trading portfolio (including derivative and non-derivative contracts). These balances are included in the caption Change in fair value of coal derivatives and coal trading activities, net in the accompanying condensed consolidated statements of income and are not included in the previous table.

During the next twelve months, based on fair values at March 31, 2011, gains on derivative contracts designated as hedge instruments in cash flow hedges of approximately \$23.5 million are expected to be reclassified from other comprehensive income into earnings.

**5. Inventories**

Inventories consist of the following:



	<b>March 31, 2011</b>	<b>December 31, 2010</b>
	<b>(In thousands)</b>	
Coal	\$ 121,363	\$ 115,647
Repair parts and supplies, net of allowance	126,545	119,969
	<b>\$ 247,908</b>	<b>\$ 235,616</b>

The repair parts and supplies are stated net of an allowance for slow-moving and obsolete inventories of \$13.0 million at March 31, 2011, and \$12.7 million at December 31, 2010.

**Table of Contents****6. Debt**

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
	<b>(In thousands)</b>	
Commercial paper	\$ 60,585	\$ 56,904
6.75% senior notes (\$450.0 million face value) due July 1, 2013	451,456	451,618
8.75% senior notes (\$600.0 million face value) due August 1, 2016	587,572	587,126
7.25% senior notes (\$500.0 million face value) due October 1, 2020	500,000	500,000
Other	8,933	14,093
	1,608,546	1,609,741
Less current maturities of debt and short-term borrowings	69,518	70,997
Long-term debt	\$ 1,539,028	\$ 1,538,744

*Availability*

The Company had no borrowings outstanding under the revolving credit facility or under the accounts receivable securitization program as of March 31, 2011 and December 31, 2010. At March 31, 2011 the Company had availability of \$860.0 million under the revolving credit facility and \$71.4 million under the accounts receivable securitization program. The Company also had outstanding letters of credit under the accounts receivable securitization program of \$76.2 million as of March 31, 2011.

**7. Fair Value Measurements**

The hierarchy of fair value measurements prioritizes the inputs to valuation techniques used to measure fair value. The levels of the hierarchy, as defined below, give the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

Level 1 is defined as observable inputs such as quoted prices in active markets for identical assets. Level 1 assets include available-for-sale equity securities and coal futures that are submitted for clearing on the New York Mercantile Exchange.

Level 2 is defined as observable inputs other than Level 1 prices. These include quoted prices for similar assets or liabilities in an active market, quoted prices for identical assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company's level 2 assets and liabilities include commodity contracts (coal and heating oil) with fair values derived from quoted prices in over-the-counter markets or from prices received from direct broker quotes.

Level 3 is defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. These include the Company's commodity option contracts (primarily coal and heating oil) valued using modeling techniques, such as Black-Scholes, that require the use of inputs, particularly volatility, that are rarely observable.

The table below sets forth, by level, the Company's financial assets and liabilities that are recorded at fair value in the accompanying condensed consolidated balance sheet:

<b>Total</b>	<b>Fair Value at March 31, 2011</b>		
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>(In thousands)</b>			

Assets:

Edgar Filing: ARCH COAL INC - Form 10-Q

Investments in equity securities	\$ 8,572	\$ 8,482	\$	\$ 90
Derivatives	39,878	6,203	17,265	16,410
Total assets	\$ 48,450	\$ 14,685	\$ 17,265	\$ 16,500
Liabilities:				
Derivatives	\$ 4,178	\$	\$ 3,459	\$ 719

The Company's contracts with certain of its counterparties allow for the settlement of contracts in an asset position with contracts in a liability position in the event of default or termination. For classification purposes, the Company records the net fair value of all the positions with these counterparties as a net asset or liability. Each level in the table above displays

**Table of Contents**

the underlying contracts according to their classification in the accompanying condensed consolidated balance sheet, based on this counterparty netting.

The following table summarizes the change in the fair values of financial instruments categorized as level 3.

	<b>Three Months Ended March 31, 2011 (In thousands)</b>
Balance, beginning of period	\$ 9,183
Realized and unrealized losses recognized in earnings	(2,579)
Realized and unrealized gains recognized in other comprehensive income	8,928
Purchases	1,466
Settlements	(1,217)
Balance, end of period	\$ 15,781

Net unrealized gains during the three month period ended March 31, 2011 related to level 3 financial instruments held on March 31, 2011 were \$7.2 million.

*Fair Value of Long-Term Debt*

At March 31, 2011 and December 31, 2010, the fair value of the Company's senior notes and other long-term debt, including amounts classified as current, was \$1,734.6 million and \$1,708.6 million, respectively. Fair values are based upon observed prices in an active market when available or from valuation models using market information.

**8. Stock-Based Compensation and Other Incentive Plans**

During the three months ended March 31, 2011, the Company granted options to purchase approximately 0.7 million shares of common stock with a weighted average exercise price of \$32.49 per share and a weighted average grant-date fair value of \$14.37 per share. The options' fair value was determined using the Black-Scholes option pricing model, using a weighted average risk-free rate of 1.95%, a weighted average dividend yield of 1.23% and a weighted average volatility of 57.61%. The options' expected life is 4.5 years and the options vest ratably over three years. The options provide for the continuation of vesting after retirement for recipients that meet certain criteria. The expense for these options will be recognized through the date that the employee first becomes eligible to retire and is no longer required to provide service to earn all or part of the award. The Company also granted 107,700 shares of restricted stock during the three months ended March 31, 2011 at a weighted average grant-date fair value of \$32.49 per share. The restricted stock vests after three years.

During the three months ended March 31, 2011, the Company awarded 3.4 million performance units as part of its long-term incentive ( LTI ) plan. The total number of units earned by a participant is based on financial and operational performance measures, and may be paid out in cash or in shares of the Company's common stock. The Company recognizes compensation expense over the three- year term of the grant. Amounts unpaid for all grants under the LTI plan totaled \$7.9 million and \$6.4 million as of March 31, 2011 and December 31, 2010, respectively.

The Company recognized compensation expense from all stock-based and LTI plans of \$6.8 million and \$3.8 million for the three months ended March 31, 2011 and 2010, respectively. This expense is primarily included in selling, general and administrative expenses in the accompanying condensed consolidated statements of income.

**9. Workers' Compensation Expense**

The following table details the components of workers' compensation expense:

	<b>Three Months Ended March 31</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Self-insured occupational disease benefits:		

Edgar Filing: ARCH COAL INC - Form 10-Q

Service cost	\$	193	\$	155
Interest cost		254		144
Net amortization		(101)		(548)
Total occupational disease		346		(249)
Traumatic injury claims and assessments		2,325		1,676
Total workers compensation expense	\$	2,671	\$	1,427

**Table of Contents****10. Employee Benefit Plans**

The following table details the components of pension benefit costs:

	<b>Three Months Ended March 31</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Service cost	\$ 4,319	\$ 3,873
Interest cost	4,131	4,121
Expected return on plan assets	(5,468)	(4,166)
Amortization of prior service cost	47	43
Amortization of other actuarial losses	2,139	2,405
Net benefit cost	\$ 5,168	\$ 6,276

The following table details the components of other postretirement benefit costs (credits):

	<b>Three Months Ended March 31</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Service cost	\$ 405	\$ 446
Interest cost	498	648
Amortization of prior service credits	(591)	(503)
Amortization of other actuarial gains	(598)	(470)
Net benefit cost (credit)	\$ (286)	\$ 121

**11. Comprehensive Income**

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income items are transactions recorded in stockholders' equity during the year, excluding net income and transactions with stockholders.

The following table presents the components of comprehensive income:

	<b>Three Months Ended March 31</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Net income (loss) attributable to Arch Coal, Inc.	\$ 55,601	\$ (1,796)
Other comprehensive income, net of income taxes:		
Pension, postretirement and other post-employment benefits, reclassifications into net income	573	592
Unrealized gains on available-for-sale securities	747	9
Unrealized gains and losses on derivatives, net of reclassifications into net income:		
Unrealized gains on derivatives	9,501	362
Reclassifications of (gains) losses into net income	(2,124)	1,723

Total comprehensive income	\$ 64,298	\$ 890
----------------------------	-----------	--------

**12. Earnings (Loss) per Common Share**

The following table provides the basis for earnings (loss) per share calculations by reconciling basic and diluted weighted average shares outstanding:

	<b>Three Months Ended March</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Weighted average shares outstanding:		
Basic weighted average shares outstanding	162,576	162,372
Effect of common stock equivalents under incentive plans	1,197	
Diluted weighted average shares outstanding	163,773	162,372

**Table of Contents**

The effect of options to purchase 1.1 million and 2.4 million shares of common stock were excluded from the calculation of diluted weighted average shares outstanding for the three month period ended March 31, 2011 and 2010, respectively, because the exercise price of these options exceeded the average market price of the Company's common stock for these periods. The additional dilutive effect of options, restricted stock and restricted stock units totaling 0.7 million shares of common stock were excluded from the calculation of diluted weighted average shares outstanding for the three months ended March 31, 2010 because of the net loss for the quarter.

**13. Guarantees**

The Company has agreed to continue to provide surety bonds and letters of credit for the reclamation and retiree healthcare obligations of Magnum Coal Company (Magnum) related to the properties the Company sold to Magnum on December 31, 2005. The purchase agreement requires Magnum to reimburse the Company for costs related to the surety bonds and letters of credit and to use commercially reasonable efforts to replace the obligations. If the surety bonds and letters of credit related to the reclamation obligations are not replaced by Magnum within a specified period of time, Magnum must post a letter of credit in favor of the Company in the amounts of the reclamation obligations. At March 31, 2011, the Company had \$86.6 million of surety bonds related to properties sold to Magnum. The surety bonding amounts are mandated by the state and are not directly related to the estimated cost to reclaim the properties. Patriot Coal Corporation (Patriot) acquired Magnum in July 2008, and has posted letters of credit in the Company's favor for \$32.7 million. In April, 2011, Patriot replaced \$22.1 million of the surety bonds.

Magnum also acquired certain coal supply contracts with customers who have not consented to the contracts assignment from the Company to Magnum. The Company has committed to purchase coal from Magnum to sell to those customers at the same price it is charging the customers for the sale. In addition, certain contracts were assigned to Magnum, but the Company has guaranteed Magnum's performance under the contracts. The longest of the coal supply contracts extends to the year 2017. If Magnum is unable to supply the coal for these coal sales contracts then the Company would be required to purchase coal on the open market or supply contracts from its existing operations. At market prices effective at March 31, 2011, the cost of purchasing 11.1 million tons of coal to supply the contracts that have not been assigned over their duration would exceed the sales price under the contracts by approximately \$429.3 million, and the cost of purchasing 1.3 million tons of coal to supply the assigned and guaranteed contracts over their duration would exceed the sales price under the contracts by approximately \$28.1 million. As the Company does not believe that it is probable that it would have to purchase replacement coal, no losses have been recorded in the consolidated financial statements as of March 31, 2011. However, if the Company would have to perform under these guarantees, it could potentially have a material adverse effect on the business, results of operations and financial condition of the Company.

In connection with the Company's acquisition of the coal operations of Atlantic Richfield Company (ARCO) and the simultaneous combination of the acquired ARCO operations and the Company's Wyoming operations into the Arch Western joint venture, the Company agreed to indemnify the other member of Arch Western against certain tax liabilities in the event that such liabilities arise prior to June 1, 2013 as a result of certain actions taken, including the sale or other disposition of certain properties of Arch Western, the repurchase of certain equity interests in Arch Western by Arch Western or the reduction under certain circumstances of indebtedness incurred by Arch Western in connection with the acquisition. If the Company were to become liable, the maximum amount of potential future tax payments is \$28.2 million at March 31, 2011, which is not recorded as a liability in the Company's condensed consolidated financial statements. Since the indemnification is dependent upon the initiation of activities within the Company's control and the Company does not intend to initiate such activities, it is remote that the Company will become liable for any obligation related to this indemnification. However, if such indemnification obligation were to arise, it could potentially have a material adverse effect on the business, results of operations and financial condition of the Company.

**14. Contingencies**

The Company is a party to numerous claims and lawsuits with respect to various matters. The Company provides for costs related to contingencies when a loss is probable and the amount is reasonably determinable. After conferring with counsel, it is the opinion of management that the ultimate resolution of pending claims will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company.



**15. Segment Information**

The Company has three reportable business segments, which are based on the major low-sulfur coal basins in which the Company operates. Each of these reportable business segments includes a number of mine complexes. The Company manages its coal sales by coal basin, not by individual mine complex. Geology, coal transportation routes to customers, regulatory environments and coal quality are generally consistent within a basin. Accordingly, market and contract pricing have developed by coal basin. Mine operations are evaluated based on their per-ton operating costs (defined as including all

**Table of Contents**

mining costs but excluding pass-through transportation expenses), as well as on other non-financial measures, such as safety and environmental performance. The Company's reportable segments are the Powder River Basin (PRB) segment, with operations in Wyoming; the Western Bituminous (WBIT) segment, with operations in Utah, Colorado and southern Wyoming; and the Central Appalachia (CAPP) segment, with operations in southern West Virginia, eastern Kentucky and Virginia.

Operating segment results for the three months ended March 31, 2011 and 2010 are presented below. Results for the operating segments include all direct costs of mining, including all depreciation, depletion and amortization related to the mining operations, even if the assets are not recorded at the operating segment level. See discussion of segment assets below. Corporate, Other and Eliminations includes the change in fair value of coal derivatives and coal trading activities, net; corporate overhead; land management; other support functions; and the elimination of intercompany transactions.

The asset amounts below represent an allocation of assets used in the segments' cash-generating activities. The amounts in Corporate, Other and Eliminations represent primarily corporate assets (cash, receivables, investments, plant, property and equipment) as well as goodwill, unassigned coal reserves, above-market acquired sales contracts and other unassigned assets.

	PRB	WBIT	CAPP (In thousands)	Corporate, Other and Eliminations	Consolidated
<b>Three months ended</b>					
<b>March 31, 2011</b>					
Coal sales	\$ 393,113	\$ 155,439	\$ 324,386	\$	\$ 872,938
Income from operations	46,874	26,892	54,394	(25,922)	102,238
Total assets	2,244,173	683,949	710,324	1,261,532	4,899,978
Depreciation, depletion and amortization	41,691	20,529	21,016	301	83,537
Amortization of acquired sales contracts, net	5,944				5,944
Capital expenditures	2,838	11,777	17,302	6,794	38,711
<b>Three months ended</b>					
<b>March 31, 2010</b>					
Coal sales	\$ 359,415	\$ 132,713	\$ 219,746	\$	\$ 711,874
Income from operations	16,561	12,430	37,593	(34,384)	32,200
Total assets	2,358,957	683,124	740,401	1,030,804	4,813,286
Depreciation, depletion and amortization	44,621	20,370	23,174	354	88,519
Amortization of acquired sales contracts, net	10,753				10,753
Capital expenditures	725	13,101	11,637	6,512	31,975

A reconciliation of segment income from operations to consolidated income (loss) before income taxes follows:

	<b>Three Months Ended March 31</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Income from operations	\$ 102,238	\$ 32,200
Interest expense	(34,580)	(35,083)

Edgar Filing: ARCH COAL INC - Form 10-Q

Interest income	746	338
Income (loss) before income taxes	\$ 68,404	\$ (2,545)

**Table of Contents**

**Note 16. Subsequent Events**

On May 2, 2011, the Company and International Coal Group, Inc. ( ICG ) entered into a definitive Agreement and Plan of Merger ( Merger Agreement ), pursuant to which the Company will commence an offer to acquire all of the outstanding shares of ICG s common stock for \$14.60 per share in cash, for a total transaction price of \$3.4 billion. Completion of the offer is subject to several conditions, including: (i) that a majority of the shares of common stock outstanding be validly tendered prior to the expiration of the offer; (ii) the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended; (iii) the absence of a material adverse effect on ICG; (iv) the expiration of a 20 business day marketing period beginning 10 business days after delivery of certain required financial information to be provided to the Company by ICG; and (v) certain other customary conditions.

The offer is not subject to a financing condition. In connection with the Merger Agreement, Arch entered into a debt commitment letter with Morgan Stanley Senior Funding, Inc., PNC Bank, National Association and PNC Capital Markets LLC ( Initial Lenders ). Pursuant to the commitment letter, the Initial Lenders have committed to provide to Arch unsecured bridge financing of up to \$3.8 billion ( Bridge Facility ), the proceeds of which will be used (i) first, to repay or redeem ICG s indebtedness outstanding on the date of consummation of the merger, other than certain existing indebtedness and (ii) second, to fund, in part, the cash consideration for the offer and pay certain fees and expenses in connection with the transactions. The Bridge Facility will mature on the first anniversary of the closing of the merger; however, Arch may, subject to certain conditions, elect to extend the maturity date of the Bridge Facility to the eighth anniversary of the closing of the merger. The Company expects to raise permanent financing comprised of a mix of debt and equity securities in amounts that enable the Company to maintain its current credit ratings.

**17. Supplemental Condensed Consolidating Financial Information**

Pursuant to the indenture governing the Arch Coal, Inc. senior notes, certain wholly-owned subsidiaries of the Company have fully and unconditionally guaranteed the senior notes on a joint and several basis. The following tables present unaudited condensed consolidating financial information for (i) the Company, (ii) the issuer of the senior notes, (iii) the guarantors under the Notes, and (iv) the entities which are not guarantors under the Notes (Arch Western Resources, LLC and Arch Receivable Company, LLC):

**Table of Contents**

**Condensed Consolidating Statements of Income**  
**Three Months Ended March 31, 2011**  
(unaudited)

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
<b>Revenue</b>					
Coal sales	\$	\$ 338,533	\$ 534,405	\$	\$ 872,938
<b>Costs, expenses and other</b>					
Cost of coal sales	3,279	251,884	423,323	(24,802)	653,684
Depreciation, depletion and amortization	672	43,277	39,588		83,537
Amortization of acquired sales contracts, net			5,944		5,944
Selling, general and administrative expenses	20,336	1,883	9,913	(1,697)	30,435
Change in fair value of coal derivatives and coal trading activities, net		(1,784)			(1,784)
Other operating (income) expense, net	(4,567)	(27,456)	4,408	26,499	(1,116)
	19,720	267,804	483,176		770,700
Income from investment in subsidiaries	125,003			(125,003)	
Income from operations	105,283	70,729	51,229	(125,003)	102,238
Interest expense, net:					
Interest expense	(40,621)	(714)	(10,982)	17,737	(34,580)
Interest income	3,742	296	14,445	(17,737)	746
	(36,879)	(418)	3,463		(33,834)
Income before income taxes	68,404	70,311	54,692	(125,003)	68,404
Provision for income taxes	12,530				12,530
Net income	55,874	70,311	54,692	(125,003)	55,874
Less: Net income attributable to noncontrolling interest	(273)				(273)
	\$ 55,601	\$ 70,311	\$ 54,692	\$ (125,003)	\$ 55,601

Net income attributable to Arch  
Coal

14

---

**Table of Contents**

**Condensed Consolidating Statements of Income**  
**Three Months Ended March 31, 2010**  
(unaudited)

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
<b>Revenue</b>					
Coal sales	\$	\$ 239,027	\$ 472,847	\$	\$ 711,874
<b>Costs, expenses and other</b>					
Cost of coal sales	2,829	168,718	397,509	(18,306)	550,750
Depreciation, depletion and amortization	752	43,717	44,050		88,519
Amortization of acquired sales contracts, net			10,753		10,753
Selling, general and administrative expenses	18,643	1,806	8,403	(1,686)	27,166
Change in fair value of coal derivatives and coal trading activities, net		5,877			5,877
Other operating (income) expense, net	(1,961)	(22,722)	1,300	19,992	(3,391)
	20,263	197,396	462,015		679,674
Income from investment in subsidiaries	47,267			(47,267)	
Income from operations	27,004	41,631	10,832	(47,267)	32,200
Interest expense, net:					
Interest expense	(31,432)	(579)	(18,115)	15,043	(35,083)
Interest income	1,883	89	13,409	(15,043)	338
	(29,549)	(490)	(4,706)		(34,745)
Income (loss) before income taxes	(2,545)	41,141	6,126	(47,267)	(2,545)
Benefit from income taxes	(775)				(775)
Net income (loss)	(1,770)	41,141	6,126	(47,267)	(1,770)
Less: Net income attributable to noncontrolling interest	(26)				(26)

Edgar Filing: ARCH COAL INC - Form 10-Q

Net income (loss) attributable to Arch Coal	\$	(1,796)	\$	41,141	\$	6,126	\$	(47,267)	\$	(1,796)
---	----	---------	----	--------	----	-------	----	----------	----	---------



**Table of Contents**

**Condensed Consolidating Balance Sheets**  
**March 31, 2011**  
**(unaudited)**

	<b>Parent/Issuer</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries (In thousands)</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>					
Cash and cash equivalents	\$ 3,056	\$ 49	\$ 66,115	\$	\$ 69,220
Receivables	28,407	14,383	262,102	(1,575)	303,317
Inventories		78,278	169,630		247,908
Other	57,279	101,506	19,712		178,497
Total current assets	88,742	194,216	517,559	(1,575)	798,942
Property, plant and equipment, net	10,017	1,780,334	1,473,204		3,263,555
Investment in subsidiaries	4,686,231			(4,686,231)	
Intercompany receivables	(1,898,150)	584,740	1,313,410		
Note receivable from Arch Western	225,000			(225,000)	
Other	454,767	371,944	10,770		837,481
Total other assets	3,467,848	956,684	1,324,180	(4,911,231)	837,481
Total assets	\$ 3,566,607	\$ 2,931,234	\$ 3,314,943	\$ (4,912,806)	\$ 4,899,978
<b>Liabilities and Stockholders Equity</b>					
Accounts payable	\$ 10,915	\$ 71,790	\$ 101,161	\$	\$ 183,866
Accrued expenses and other current liabilities	61,757	31,951	140,210	(1,575)	232,343
Current maturities of debt and short-term borrowings	8,933		60,585		69,518
Total current liabilities	81,605	103,741	301,956	(1,575)	485,727
Long-term debt	1,087,572		451,456		1,539,028
Note payable to Arch Coal			225,000	(225,000)	
Asset retirement obligations	652	32,649	303,674		336,975
Accrued pension benefits	14,363	4,535	19,910		38,808
Accrued postretirement benefits other than pension	14,290		22,630		36,920
Accrued workers compensation	15,359	13,723	6,882		35,964

Edgar Filing: ARCH COAL INC - Form 10-Q

Other noncurrent liabilities	50,453	20,790	53,000		124,243
Total liabilities	1,264,294	175,438	1,384,508	(226,575)	2,597,665
Redeemable noncontrolling interest	10,718				10,718
Stockholders equity	2,291,595	2,755,796	1,930,435	(4,686,231)	2,291,595
Total liabilities and stockholders equity	\$ 3,566,607	\$ 2,931,234	\$ 3,314,943	\$ (4,912,806)	\$ 4,899,978

**Table of Contents**

**Condensed Consolidating Balance Sheets**  
**December 31, 2010**  
**(unaudited)**

	<b>Parent/Issuer</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries (In thousands)</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>					
Cash and cash equivalents	\$ 13,713	\$ 64	\$ 79,816	\$	\$ 93,593
Receivables	31,458	12,740	210,075	(1,953)	252,320
Inventories		85,196	150,420		235,616
Other	29,575	102,375	21,435		153,385
Total current assets	74,746	200,375	461,746	(1,953)	734,914
Property, plant and equipment, net	9,817	1,800,578	1,498,497		3,308,892
Investment in subsidiaries	4,555,233			(4,555,233)	
Intercompany receivables	(1,807,902)	508,624	1,299,278		
Note receivable from Arch Western	225,000			(225,000)	
Other	481,345	344,698	10,920		836,963
Total other assets	3,453,676	853,322	1,310,198	(4,780,233)	836,963
Total assets	\$ 3,538,239	\$ 2,854,275	\$ 3,270,441	\$ (4,782,186)	\$ 4,880,769
<b>Liabilities and Stockholders Equity</b>					
Accounts payable	\$ 10,753	\$ 65,793	\$ 121,670	\$	\$ 198,216
Accrued expenses and other current liabilities	75,746	31,123	153,217	(1,953)	258,133
Current maturities of debt and short-term borrowings	14,093		56,904		70,997
Total current liabilities	100,592	96,916	331,791	(1,953)	527,346
Long-term debt	1,087,126		451,618		1,538,744
Note payable to Arch Coal			225,000	(225,000)	
Asset retirement obligations	873	32,029	301,355		334,257
Accrued pension benefits	20,843	4,407	23,904		49,154
Accrued postretirement benefits other than pension	14,284		23,509		37,793
Accrued workers compensation	15,383	13,805	6,102		35,290

Edgar Filing: ARCH COAL INC - Form 10-Q

Other noncurrent liabilities	51,187	22,135	36,912		110,234
Total liabilities	1,290,288	169,292	1,400,191	(226,953)	2,632,818
Redeemable noncontrolling interest	10,444				10,444
Stockholders equity	2,237,507	2,684,983	1,870,250	(4,555,233)	2,237,507
Total liabilities and stockholders equity	\$ 3,538,239	\$ 2,854,275	\$ 3,270,441	\$ (4,782,186)	\$ 4,880,769

**Table of Contents**

**Condensed Consolidating Statements of Cash Flows**  
**Three Months Ended March 31, 2011**  
**(unaudited)**

	<b>Parent/Issuer</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidated</b>
	<b>(In thousands)</b>			
Cash provided by (used in) operating activities	\$ (75,477)	\$ 144,796	\$ 16,826	\$ 86,145
<b>Investing Activities</b>				
Capital expenditures	(900)	(23,615)	(14,196)	(38,711)
Proceeds from dispositions of property, plant and equipment		502	14	516
Purchases of investments and advances to affiliates	(9,529)	(24,890)		(34,419)
Additions to prepaid royalties		(20,915)		(20,915)
Cash used in investing activities	(10,429)	(68,918)	(14,182)	(93,529)
<b>Financing Activities</b>				
Net increase in borrowings under lines of credit and commercial paper program			3,681	3,681
Net proceeds from other debt	(5,161)			(5,161)
Debt financing costs			(8)	(8)
Dividends paid	(16,269)			(16,269)
Issuance of common stock under incentive plans	768			768
Transactions with affiliates, net	95,911	(75,893)	(20,018)	
Cash provided by (used in) financing activities	75,249	(75,893)	(16,345)	(16,989)
Decrease in cash and cash equivalents	(10,657)	(15)	(13,701)	(24,373)
Cash and cash equivalents, beginning of period	13,713	64	79,816	93,593
Cash and cash equivalents, end of period	\$ 3,056	\$ 49	\$ 66,115	\$ 69,220

**Table of Contents**

**Condensed Consolidating Statements of Cash Flows**  
**Three Months Ended March 31, 2010**  
**(unaudited)**

	<b>Parent/Issuer</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Consolidated</b>
	<b>(in thousands)</b>			
Cash provided by (used in) operating activities	\$ (74,952)	\$ 112,334	\$ 55,949	\$ 93,331
<b>Investing Activities</b>				
Capital expenditures	(711)	(17,438)	(13,826)	(31,975)
Proceeds from dispositions of property, plant and equipment		21	74	95
Purchases of investments and advances to affiliates	(8,856)	(1,215)		(10,071)
Additions to prepaid royalties		(20,831)	(2,509)	(23,340)
Cash used in investing activities	(9,567)	(39,463)	(16,261)	(65,291)
<b>Financing Activities</b>				
Net increase (decrease) in borrowings under lines of credit and commercial paper program	(30,000)		10,676	(19,324)
Net payments on other debt	(4,742)			(4,742)
Debt financing costs			(200)	(200)
Dividends paid	(14,623)			(14,623)
Issuance of common stock under incentive plans	85			85
Transactions with affiliates, net	119,514	(72,871)	(46,643)	
Cash provided by (used in) financing activities	70,234	(72,871)	(36,167)	(38,804)
Increase (decrease) in cash and cash equivalents	(14,285)		3,521	(10,764)
Cash and cash equivalents, beginning of period	54,255	64	6,819	61,138
Cash and cash equivalents, end of period	\$ 39,970	\$ 64	\$ 10,340	\$ 50,374

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.****Overview**

We are one of the world's largest coal producers by volume. We sell the majority of our coal as steam coal to power plants and industrial facilities. We also sell metallurgical coal used in steel production. The locations of our mines and access to export facilities enable us to ship coal to most of the major coal-fueled power plants, industrial facilities and steel mills located within the United States and on four continents worldwide. Our three reportable business segments are based on the low-sulfur U.S. coal producing regions in which we operate—the Powder River Basin, the Western Bituminous region and the Central Appalachia region. These geographically distinct areas are characterized by geology, coal transportation routes to consumers, regulatory environments and coal quality. These regional distinctions have caused market and contract pricing environments to develop by coal region and form the basis for the segmentation of our operations.

The Powder River Basin is located in northeastern Wyoming and southeastern Montana. The coal we mine from surface operations in this region is very low in sulfur content and has a low heat value compared to the other regions in which we operate. The price of Powder River Basin coal is generally less than that of coal produced in other regions because Powder River Basin coal exists in greater abundance, is easier to mine and thus has a lower cost of production. In addition, Powder River Basin coal is generally lower in heat content, which requires some electric power generation facilities to blend it with higher Btu coal or retrofit some existing coal plants to accommodate lower Btu coal. The Western Bituminous region includes Colorado, Utah and southern Wyoming. Coal we mine from underground and surface mines in this region typically is low in sulfur content and varies in heat content. Central Appalachia includes eastern Kentucky, Tennessee, Virginia and southern West Virginia. Coal we mine from both surface and underground mines in this region generally has high heat content and low sulfur content. In addition, we may sell a portion of the coal we produce in the Central Appalachia region as metallurgical coal, which has high heat content, low expansion pressure, low sulfur content and various other chemical attributes. As such, the prices at which we sell metallurgical coal to customers in the steel industry generally exceed the prices for steam coal offered by power plants and industrial users.

Growth in domestic and global coal demand combined with coal supply constraints in many traditional coal exporting countries benefited coal markets during 2010. We expect global coal markets to remain tight throughout the remainder of 2011, and additional tightening in the domestic market as 2011 progresses. Through March, year-to-date global steel production increased more than 9%; and over 20% from recessionary levels. We expect metallurgical coal production to increase in coming years to meet the increasing steel demand for infrastructure in both developing economies, such as China and Brazil, and mature economies, particularly Japan, where significant rebuilding will be necessary after the earthquake and tsunami. As in metallurgical coal markets, markets for U.S. steam coal are also migrating offshore to meet the continuing growth in global coal demand.

In response to the global steam coal demand, we have expanded our seaborne sales and have shipped steam coal to Europe, South America, and small volumes to Asia. Each of our operating segments is participating in the expansion of seaborne shipments utilizing ports on the East and West Coasts as well as on the Gulf of Mexico.

Geologic issues at our Mountain Laurel mine in Central Appalachia caused the temporary idling of our longwall at the mine during the first quarter of 2011. The geologic challenges required us to perform additional work on the panel that had been in development, and we instead moved the longwall to a different panel after completing development work there. Despite the idling, we were still able to ship 1.4 million tons of metallurgical-quality coal during the first quarter, due to the operation of five continuous miner units operating at Mountain Laurel, shipments from inventories on hand and increased metallurgical-quality coal shipments from other operations. We resumed longwall production in mid-April and expect our shipments of metallurgical-quality coal to increase as the year progresses. We expect to ship approximately 7.5 million tons of metallurgical-quality coal in 2011, exclusive of the impact of the planned acquisition discussed below.

On May 2, 2011, we entered into a definitive Agreement and Plan of Merger ( Merger Agreement ) with International Coal Group, Inc. ( ICG ), pursuant to which the Company will commence an offer to acquire all of the outstanding shares of ICG's common stock for \$14.60 per share in cash, for a total transaction value of \$3.4 billion.

Completion of the offer is subject to customary conditions. The offer is not subject to a financing condition.

ICG's assets include 13 active mining complexes located throughout West Virginia, Kentucky, Virginia, Maryland and Illinois and one major mining complex under development. Of ICG's predominantly underground reserve base of 1.1 billion tons, nearly 30% is metallurgical-quality. After the acquisition, we will have assets in every major U.S. coal supply basin. In 2010, ICG sold 16.3 million tons of coal and reported coal sales revenues of \$1.1 billion and net income of \$30.1 million.



**Table of Contents****Results of Operations****Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010**

*Summary.* Our improved results during the first quarter of 2011 when compared to the first quarter of 2010 were due primarily to higher average sales realizations as a result of improved market conditions. Higher per-ton production costs partially offset the benefit from the higher average realizations.

*Revenues.* The following table summarizes information about coal sales during the three months ended March 31, 2011 and compares it with the information for the three months ended March 31, 2010:

	<b>Three Months Ended March</b>		<b>Increase (Decrease)</b>	
	<b>2011</b>	<b>2010</b>	<b>Amount</b>	<b>%</b>
	<b>(Amounts in thousands, except per ton data and percentages)</b>			
Coal sales	\$872,938	\$711,874	\$161,064	22.6%
Tons sold	36,608	37,806	(1,198)	(3.2)%
Coal sales realization per ton sold	\$ 23.85	\$ 18.83	\$ 5.02	26.7%

Coal sales increased in the first quarter of 2011 from the first quarter of 2010, due to an increase in the overall average price per ton sold, primarily from the effect of an increase in the volumes and pricing of metallurgical-quality coal sold, higher steam pricing in all regions and the impact of changes in regional mix on our average coal sales realization. Overall sales volume decreased slightly due to lower sales volumes in the Powder River Basin. We remain selective in committing tonnage by matching our production levels to our estimates of market demand, which we believe will provide for the best long-term results based on our outlook for the coal markets. We have provided more information about the tons sold and the coal sales realizations per ton by operating segment under the heading *Operating segment results* .

*Costs, expenses and other.* The following table summarizes costs, expenses and other components of operating income for the three months ended March 31, 2011 and compares it with the information for the three months ended March 31, 2010:

	<b>Three Months Ended</b>		<b>Increase (Decrease)</b>	
	<b>2011</b>	<b>2010</b>	<b>\$</b>	<b>%</b>
	<b>(Amounts in thousands, except percentages)</b>			
Cost of coal sales	\$ 653,684	\$ 550,750	\$ (102,934)	(18.7)%
Depreciation, depletion and amortization	83,537	88,519	4,982	5.6
Amortization of acquired sales contracts, net	5,944	10,753	4,809	44.7
Selling, general and administrative expenses	30,435	27,166	(3,269)	(12.0)
Change in fair value of coal derivatives and coal trading activities, net	(1,784)	5,877	7,661	130.4
Other operating income, net	(1,116)	(3,391)	(2,275)	(67.1)
	\$ 770,700	\$ 679,674	\$ (91,026)	(13.4)%

*Cost of coal sales.* Our cost of coal sales increased in 2011 from 2010 primarily due to higher per-ton production costs, an increase in sales-sensitive costs and an increase in transportation costs, as a result of the increase in export shipments. Higher per ton production-costs were affected by the longwall outage at Mountain Laurel during the quarter and the impact of changes in regional mix. We have provided more information about our operating segments under the heading *Operating segment results* .

*Depreciation, depletion and amortization.* When compared with 2010, lower depreciation, depletion and amortization costs in 2011 resulted primarily from the impact of lower production and sales volumes on assets

amortized or depleted on the basis of tons produced.

*Amortization of acquired sales contracts, net.* We acquired both above- and below-market sales contracts with a net fair value of \$58.4 million with the Jacobs Ranch mining operation. The fair values of acquired sales contracts are amortized over the tons of coal shipped during the term of the contracts.

**Table of Contents**

*Selling, general and administrative expenses.* The increase in selling, general and administrative expenses in 2011 is due primarily to higher compensation-related costs and an increase in professional services fees.

*Change in fair value of coal derivatives and coal trading activities, net.* Net (gains) losses relate to the net impact of our coal trading activities and the change in fair value of other coal derivatives that have not been designated as hedge instruments in a hedging relationship. In 2010, rising coal prices resulted in unrealized losses on positions held to manage risk, but that were not designated in a hedge relationship.

*Other operating income, net.* The decrease in net other operating income in 2011 from 2010 is primarily the result of a decrease in income from commercial activity.

*Operating segment results.* The following table shows results by operating segment for the three months ended March 31, 2011 and compares it with the information for the three months ended March 31, 2010:

	<b>Three Months Ended March</b>		<b>Increase (Decrease)</b>	
	<b>2011</b>	<b>31 2010</b>	<b>\$</b>	<b>%</b>
<i>Powder River Basin</i>				
Tons sold (in thousands)	28,830	30,645	(1,815)	(5.9)%
Coal sales realization per ton sold(1)	\$ 13.51	\$ 11.64	\$ 1.87	16.1%
Operating margin per ton sold(2)	\$ 1.60	\$ 0.51	\$ 1.09	213.7%
Adjusted EBITDA(3)	\$93,716	\$69,403	\$24,313	35.0%
<i>Western Bituminous</i>				
Tons sold (in thousands)	4,186	4,129	57	1.4%
Coal sales realization per ton sold(1)	\$ 31.77	\$ 28.97	\$ 2.80	9.7%
Operating margin per ton sold(2)	\$ 6.35	\$ 2.59	\$ 3.76	145.2%
Adjusted EBITDA(3)	\$47,420	\$32,799	\$14,621	44.6%
<i>Central Appalachia</i>				
Tons sold (in thousands)	3,592	3,032	560	18.5%
Coal sales realization per ton sold(1)	\$ 80.92	\$ 66.29	\$ 14.63	22.1%
Operating margin per ton sold(2)	\$ 16.00	\$ 11.74	\$ 4.26	36.3%
Adjusted EBITDA(3)	\$77,986	\$57,421	\$20,565	35.8%

(1) Coal sales prices per ton exclude certain transportation costs that we pass through to our customers. We use these financial measures because we believe the amounts as adjusted better represent the coal sales prices we achieved within our operating segments. Since other companies may calculate coal sales prices per ton differently, our calculation may not be comparable to similarly titled measures used by those companies. For the three months ended March 31, 2011, transportation costs per ton were \$0.13 for the Powder River Basin, \$5.36 for the Western Bituminous region and \$9.39 for Central Appalachia. For the three months ended March 31, 2010, transportation costs per ton were \$0.08 for the Powder River Basin, \$3.17 for the Western Bituminous region and \$6.19 for Central Appalachia.

(2) Operating margin per ton sold is calculated as coal sales revenues less cost of coal sales and depreciation, depletion and amortization divided by tons sold.

(3) Adjusted EBITDA is defined as net income attributable to the Company before the effect of net interest expense, income taxes, depreciation, depletion and amortization and the amortization of acquired sales contracts. Adjusted EBITDA may also be adjusted for items that may not reflect the trend of future results. Segment Adjusted EBITDA is reconciled to net income at the end of this *Results of Operations* section.

*Powder River Basin* Segment Adjusted EBITDA was \$93.7 million, or 35%, higher in 2011 than in 2010 due to higher average coal sales realizations, reflecting the improved coal markets. The decrease in sales volumes in the Powder River Basin in 2011 when compared with 2010 resulted primarily from our market-driven sales commitment

approach, as discussed previously. Partially offsetting the increase in average realizations was an increase in labor and diesel costs and an increase in sales-sensitive costs, due to increased realizations.

*Western Bituminous* Segment EBITDA was \$47.4 million in 2011, or 45% higher than 2010, reflecting improved pricing, despite the ongoing soft domestic demand in the region. Effective cost control in the region and slightly higher production levels reduced our per-ton operating costs, which contributed to the improved results in 2011.

*Central Appalachia* Segment EBITDA was \$78.0 million in 2011, or 36% higher than in 2010, triggered primarily by an increase in the volumes and pricing of metallurgical-quality coal sold. We were able to increase the volumes of metallurgical quality coal sold, despite the temporary outage of Mountain Laurel's longwall during the quarter, by operating

**Table of Contents**

five continuous miner units at Mountain Laurel, shipping from inventories on hand and increasing metallurgical-quality coal shipments from other complexes in the region. We sold approximately 1.4 million tons of metallurgical-quality coal in 2011 compared to 0.9 million tons in 2010. Because metallurgical coal generally commands a higher price than steam coal, the increase had a favorable impact on our average realizations compared to 2010. The benefit from higher per-ton realizations in 2011, net of sales sensitive costs, drove the improvement in our operating margins over 2010, partially offset by the impacts of the outage and increasing production at higher cost mines on our average per-ton production costs.

*Net interest expense.* The following table summarizes our net interest expense for the three months ended March 31, 2011 and compares it with the information for the three months ended March 31, 2010:

	Three Months Ended		Increase	
	March 31		in Net Income	
	2011	2010	\$	%
	(Amounts in thousands, except percentages)			
Interest expense	\$ (34,580)	\$ (35,083)	\$ 503	1.4%
Interest income	746	338	408	120.7%
	\$ (33,834)	\$ (34,745)	\$ 911	2.6%

*Income taxes.* Our effective income tax rate is sensitive to changes in and the relationship between annual profitability and the deduction for percentage depletion. The following table summarizes our income taxes for three months ended March 31, 2011 and compares it with the information for the three months ended March 31, 2010:

	Three Months Ended		Decrease	
	March 31		in Net Income	
	2011	2010	\$	%
	(Amounts in thousands, except percentages)			
Provision for (benefit from) income taxes	\$ 12,530	\$ (775)	\$ (13,305)	N/A

The Company's effective rate of 18% in the first quarter of 2011 reflects a more normalized effective rate as a result of the profits generated in the current quarter.

**Reconciliation of Segment Adjusted EBITDA to Net Income**

The discussion in Results of Operations includes references to our Adjusted EBITDA results. Adjusted EBITDA is defined as net income attributable to the Company before the effect of net interest expense, income taxes, depreciation, depletion and amortization and the amortization of acquired sales contracts. Adjusted EBITDA may also be adjusted for items that may not reflect the trend of future results. We believe that Adjusted EBITDA presents a useful measure of our ability to service and incur debt based on ongoing operations. Investors should be aware that our presentation of Adjusted EBITDA may not be comparable to similarly titled measures used by other companies. The table below shows how reconcile Adjusted EBITDA to net income attributable to Arch Coal.

	Three Months Ended March	
	31	
	2011	2010
Segment Adjusted EBITDA	\$ 219,122	\$ 159,623
Corporate and other Adjusted EBITDA (1)	(27,676)	(28,177)
Adjusted EBITDA	191,446	131,446
Depreciation, depletion and amortization	(83,537)	(88,519)

Edgar Filing: ARCH COAL INC - Form 10-Q

Amortization of acquired sales contracts, net	(5,944)	(10,753)
Interest expense	(34,580)	(35,083)
Interest income	746	338
(Provision for) benefit from income taxes	(12,530)	775
Net income attributable to Arch Coal	\$ 55,601	\$ (1,796)

(1) Corporate and other Adjusted EBITDA includes primarily selling, general and administrative expenses, income from our equity investments, change in fair value of coal derivatives and coal trading activities, net.

**Liquidity and Capital Resources**

*Liquidity and capital resources*

Our primary sources of cash are coal sales to customers, borrowings under our credit facilities and other financing arrangements, and debt and equity offerings related to significant transactions. Excluding any significant mineral reserve

**Table of Contents**

acquisitions, we generally satisfy our working capital requirements and fund capital expenditures and debt-service obligations with cash generated from operations or borrowings under our credit facility, accounts receivable securitization or commercial paper programs. The borrowings under these arrangements are classified as current if the underlying credit facilities expire within one year or if, based on cash projections and management plans, we do not have the intent to replace them on a long-term basis. Such plans are subject to change based on our cash needs.

We believe that cash generated from operations and borrowings under our credit facilities or other financing arrangements will be sufficient to meet working capital requirements, anticipated capital expenditures and scheduled debt payments for at least the next several years. We manage our exposure to changing commodity prices for our non-trading, long-term coal contract portfolio through the use of long-term coal supply agreements. We enter into fixed price, fixed volume supply contracts with terms greater than one year with customers with whom we have historically had limited collection issues. Our ability to satisfy debt service obligations, to fund planned capital expenditures, to make acquisitions, to repurchase our common shares and to pay dividends will depend upon our future operating performance, which will be affected by prevailing economic conditions in the coal industry and financial, business and other factors, some of which are beyond our control.

During the three months ended March 31, 2011, our borrowing levels remained flat, with no borrowings under the revolving credit facility and accounts receivable securitization program. At March 31, 2011, our debt-to-capitalization ratio (defined as total debt divided by the sum of total debt and equity) was 41% and our availability under lines of credit was \$931.4 million.

Our indebtedness consisted of the following:

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
	<b>(In thousands)</b>	
Commercial paper	\$ 60,585	\$ 56,904
6.75% senior notes (\$450.0 million face value) due July 1, 2013	451,456	451,618
8.75% senior notes (\$600.0 million face value) due August 1, 2016	587,572	587,126
7.25% senior notes (\$500.0 million face value) due October 1, 2020	500,000	500,000
Other	8,933	14,093
	1,608,546	1,609,741
Less current maturities of debt and short-term borrowings	69,518	70,997
Long-term debt	\$ 1,539,028	\$ 1,538,744

In connection with the Merger Agreement with ICG, we entered into a debt commitment letter with Morgan Stanley Senior Funding, Inc., PNC Bank, National Association and PNC Capital Markets LLC ( Initial Lenders ). Pursuant to the commitment letter, the Initial Lenders have committed to provide to us unsecured bridge financing of up to \$3.8 billion ( Bridge Facility ), the proceeds of which will be used (i) first, to repay or redeem ICG's indebtedness outstanding on the date of consummation of the merger, other than certain existing indebtedness and (ii) second, to fund, in part, the cash consideration for the offer and pay certain fees and expenses in connection with the transactions. The Bridge Facility will mature on the first anniversary of the closing of the merger; however, we may, subject to certain conditions, elect to extend the maturity date of the Bridge Facility to the eighth anniversary of the closing of the merger. We expect to raise permanent financing comprised of a mix of debt and equity securities in amounts that enable us to maintain its current credit ratings.

The following is a summary of cash provided by or used in each of the indicated types of activities:

**Three Months Ended March  
31,**

	<b>2011</b>	<b>2010</b>
	<b>(Dollars in thousands)</b>	
Cash provided by (used in):		
Operating activities	\$ 86,145	\$ 93,331
Investing activities	(93,529)	(65,291)
Financing activities	(16,989)	(38,804)

Cash provided by operating activities decreased slightly in the first quarter of 2011 compared to the first quarter of 2010, due to an increased investment in working capital, primarily trade receivables. March 2011 was a record month for revenues for the Company, resulting in a higher quarter-end balance in trade receivables.

Cash used in investing activities in the first quarter of 2011 was \$28.2 million more than in the first quarter of 2010, due to investments in and advances to equity-method investees totaling approximately \$34.4 million, compared to \$10.1 million in 2010. This included approximately \$25.0 million to purchase a 38% ownership interest in Millennium Bulk Terminals-Longview, LLC and a \$5.5 million milestone payment made to Tenaska Trailblazer Partners, LLC, ( Tenaska ) the developer of the Trailblazer Energy Center. During the first quarter of 2011 our capital expenditures were \$6.7 million higher than in the first quarter of 2010. Capital expenditures in the first quarter of 2010 were the lowest quarterly total in the previous six years.

Cash used in financing activities was \$21.8 million lower in the than in the first quarter of 2010. As mentioned previously, we did not borrow under our accounts receivable securitization program or revolving credit facility during the



**Table of Contents**

first quarter of 2011. In the first quarter of 2010, we repaid \$19.3 million under our various lines of credit. We paid dividends of \$16.3 million in the three months ended March 31, 2011 and \$14.6 million in the three months ended March 31, 2010.

**Ratio of Earnings to Fixed Charges**

The following table sets forth our ratios of earnings to combined fixed charges and preference dividends for the periods indicated:

	<b>Three Months Ended March</b>	
	<b>31</b>	
	<b>2011</b>	<b>2010</b>
Ratio of earnings to combined fixed charges and preference dividends	2.84x	0.92x

**Critical Accounting Policies**

For a description of our critical accounting policies, see Critical Accounting Policies under Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2010. There have been no significant changes to our critical accounting policies during the three months ended March 31, 2011.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

We manage our commodity price risk for our non-trading, long-term coal contract portfolio through the use of long-term coal supply agreements, and to a limited extent, through the use of derivative instruments. Our commitments for the full year 2011 and 2012 are as follows:

<b>(Tons in millions)</b>	<b>2011</b>		<b>2012</b>	
	<b>Tons</b>	<b>Price</b>	<b>Tons</b>	<b>Price</b>
<i>Powder River Basin</i>				
Committed, priced	109.8	\$ 13.64	69.2	\$ 14.25
Committed, unpriced	5.2		11.0	
<i>Western Bituminous</i>				
Committed, priced	17.5	\$ 32.22	9.9	\$ 35.46
<i>Central Appalachia</i>				
Committed, priced (Coking, PCI)	5.8	\$ 113.42	0.4	\$ 120.88
Committed, priced (Steam)	6.8	\$ 67.12	1.5	\$ 74.08

We are exposed to commodity price risk in our coal trading activities, which represents the potential future loss that could be caused by an adverse change in the market value of coal. Our coal trading portfolio included forward, swap and put and call option contracts at March 31, 2011. The estimated future realization of the \$11.8 million fair value of the trading portfolio is 47% for the remainder of 2011, 49% in 2012 and 4% in 2013.

We monitor and manage market price risk for our trading activities with a variety of tools, including Value at Risk (VaR), position limits, management alerts for mark to market monitoring and loss limits, scenario analysis, sensitivity analysis and review of daily changes in market dynamics. Management believes that presenting high, low, end of year and average VaR is the best available method to give investors insight into the level of commodity risk of our trading positions. Illiquid positions, such as long-dated trades that are not quoted by brokers or exchanges, are not included in VaR.

VaR is a statistical one-tail confidence interval and down side risk estimate that relies on recent history to estimate how the value of the portfolio of positions will change if markets behave in the same way as they have in the recent past. While presenting VaR will provide a similar framework for discussing risk across companies, VaR estimates from two independent sources are rarely calculated in the same way. Without a thorough understanding of how each VaR model was calculated, it would be difficult to compare two different VaR calculations from different sources. The level of confidence is 95%. The time across which these possible value changes are being estimated is through the end of the next business day. A closed-form delta-neutral method used throughout the finance and energy sectors is employed to calculate this VaR. VaR is back tested to verify usefulness.

On average, portfolio value should not fall more than VaR on 95 out of 100 business days. Conversely, portfolio value declines of more than VaR should be expected, on average, 5 out of 100 business days. When more value than VaR is lost due to market price changes, VaR is not representative of how much value beyond VaR will be lost.

**Table of Contents**

During the three months ended March 31, 2011, VaR ranged from \$1.2 million to \$1.9 million. The linear mean of each daily VaR was \$1.5 million. The final VaR at March 31, 2011 was \$1.9 million.

We are also exposed to the risk of fluctuations in cash flows related to our purchase of diesel fuel. We use approximately 55 million to 65 million gallons of diesel fuel annually in our operations. We enter into forward physical purchase contracts, as well as heating oil swaps and options, to reduce volatility in the price of diesel fuel for our operations. At March 31, 2011, we had protected the price of approximately 63% of its remaining expected purchases for fiscal year 2011 and 5% for fiscal year 2012, mostly through the use of the derivative instruments noted above. Since the changes in the price of heating oil are highly correlated to changes in the price of the hedged diesel fuel purchases, the heating oil swaps and purchased call options qualify for cash flow hedge accounting. Accordingly, changes in the fair value of the derivatives are recorded through other comprehensive income, with any ineffectiveness recognized immediately in income. At March 31, 2011, a \$0.25 per gallon decrease in the price of heating oil would result in an approximate \$2.1 million increase in our expense related to the heating oil derivatives, which, if realized, would be offset by a decrease in the cost of our physical diesel purchases.

We are exposed to market risk associated with interest rates due to our existing level of indebtedness. At March 31, 2011, of our \$1.6 billion principal amount of debt outstanding, \$60.6 million of outstanding borrowings have interest rates that fluctuate based on changes in the market rates. A one percentage point increase in the interest rates related to these borrowings would result in an annualized increase in interest expense of \$0.6 million.

**Item 4. Controls and Procedures.**

We performed an evaluation under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2011. Based on that evaluation, our management, including our chief executive officer and chief financial officer, concluded that the disclosure controls and procedures were effective as of such date. There were no changes in internal control over financial reporting that occurred during our fiscal quarter ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II OTHER INFORMATION

**Item 1. Legal Proceedings**

We are involved in various claims and legal actions arising in the ordinary course of business, including employee injury claims. After conferring with counsel, it is the opinion of management that the ultimate resolution of these claims, to the extent not previously provided for, will not have a material adverse effect on our consolidated financial condition, results of operations or liquidity.

**Permit Litigation Matters**

As described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, surface mines at our Mingo Logan and Coal-Mac mining operations were identified in an existing lawsuit brought by the Ohio Valley Environmental Coalition (OVEC) in the U.S. District Court for the Southern District of West Virginia as having been granted Clean Water Act § 404 permits by the Army Corps of Engineers, allegedly in violation of the Clean Water Act and the National Environmental Policy Act.

The lawsuit, brought by OVEC in September 2005, originally was filed against the Corps for permits it had issued to four subsidiaries of a company unrelated to us or our operating subsidiaries. The suit claimed that the Corps had issued permits to the subsidiaries of the unrelated company that did not comply with the National Environmental Policy Act and violated the Clean Water Act.

The court ruled on the claims associated with those four permits in orders of March 23 and June 13, 2007. In the first of those orders, the court rescinded the four permits, finding that the Corps had inadequately assessed the likely impact of valley fills on headwater streams and had relied on inadequate or unproven mitigation to offset those impacts. In the second order, the court entered a declaratory judgment that discharges of sediment from the valley fills into sediment control ponds constructed in-stream to control that sediment must themselves be permitted under a different provision of the Clean Water



**Table of Contents**

Act, § 402, and meet the effluent limits imposed on discharges from these ponds. Both of the district court rulings were appealed to the U.S. Court of Appeals for the Fourth Circuit.

Before the court entered its first order, the plaintiffs were permitted to amend their complaint to challenge the Coal-Mac and Mingo Logan permits. Plaintiffs sought preliminary injunctions against both operations, but later reached agreements with our operating subsidiaries that have allowed mining to progress in limited areas while the district court's rulings were on appeal. The claims against Coal-Mac were thereafter dismissed.

In February 2009, the Fourth Circuit reversed the District Court. The Fourth Circuit held that the Corps' jurisdiction under Section 404 of the Clean Water Act is limited to the narrow issue of the filling of jurisdictional waters. The court also held that the Corps' findings of no significant impact under the National Environmental Policy Act and no significant degradation under the Clean Water Act are entitled to deference. Such findings entitle the Corps to avoid preparing an environmental impact statement, the absence of which was one issue on appeal. These holdings also validated the type of mitigation projects proposed by our operations to minimize impacts and comply with the relevant statutes. Finally, the Fourth Circuit found that stream segments, together with the sediment ponds to which they connect, are unitary waste treatment systems, not waters of the United States, and that the Corps had not exceeded its authority in permitting them.

The Ohio Valley Environmental Coalition sought rehearing before the entire appellate court, which was denied in May, 2009, and the decision was given legal effect in June 2009. An appeal to the U.S. Supreme Court was then filed in August 2009. On August 3, 2010 OVEC withdrew its appeal.

Mingo Logan filed a motion for summary judgment with the district court in July 2009, asking that judgment be entered in its favor because no outstanding legal issues remained for decision as a result of the Fourth Circuit's February 2009 decision. By a series of motions, the United States obtained extensions and stays of the obligation to respond to the motion in the wake of its letters to the Corps dated September 3 and October 16, 2009 (discussed below). By order dated April 22, 2010, the District Court stayed the case as to Mingo Logan for the shorter of either six months or the completion of the U.S. Environmental Protection Agency's (the EPA) proposed action to deny Mingo Logan the right to use its Corps permit (as discussed below).

On October 15, 2010, the United States moved to extend the existing stay for an additional 120 days (until February 22, 2011) while the EPA Administrator reviews the Recommended Determination issued by EPA Region 3. By Memorandum Opinion and Order dated November 2, 2010, the court granted the United States' motion. On January 13, 2011, EPA issued its Final Determination to withdraw the specification of two of the three watersheds as a disposal site for dredged or fill material approved under the current Section 404 permit. The court has been notified of the Final Determination.

Additional information can be obtained from the U.S. District Court for the Southern District of West Virginia.

**EPA Actions related to water discharges from the Spruce Permit**

As described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, by letter of September 3, 2009, the EPA asked the Corps of Engineers to suspend, revoke or modify the existing permit it issued in January 2007 to Mingo Logan under Section 404 of the Clean Water Act, claiming that new information and circumstances have arisen which justify reconsideration of the permit. By letter of September 30, 2009, the Corps of Engineers advised the EPA that it would not reconsider its decision to issue the permit. By letter of October 16, 2009, the EPA advised the Corps that it has reason to believe that the Mingo Logan mine will have unacceptable adverse impacts to fish and wildlife resources and that it intends to issue a public notice of a proposed determination to restrict or prohibit discharges of fill material that already are approved by the Corps permit. By federal register publication dated April 2, 2010, EPA issued its Proposed Determination to Prohibit, Restrict or Deny the Specification, or the Use for Specification of an Area as a Disposal Site: Spruce No. 1 Surface Mine, Logan County, WV pursuant to Section 404 c of the Clean Water Act. EPA accepted written comments on its proposed action (sometimes known as a veto proceeding), through June 4, 2010 and conducted a public hearing, as well, on May 18, 2010. We submitted comments on the action during this period. On September 24, 2010, EPA Region 3 issued a Recommended Determination to the EPA Administrator recommending that EPA prohibit the placement of fill material in two of the three watersheds for which filling is approved under the current Section 404 permit. Mingo Logan, along with the Corps, West Virginia DEP and the mineral owner, engaged in a consultation with EPA as required by the regulations,

to discuss corrective action to address the unacceptable adverse effects identified. On January 13, 2011, EPA issued its Final Determination pursuant to Section 404(c) of the Clean Water Act to withdraw the specification of two of the three watersheds approved in the current Section 404 permit as a disposal site for dredged or fill material. By separate action, Mingo Logan sued EPA on April 2, 2010 in federal court in Washington, D.C. seeking a ruling

**Table of Contents**

that EPA has no authority under the Clean Water Act to veto a previously issued permit (Mingo Logan Coal Company, Inc. v. USEPA, No. 1:10-cv-00541(D.D.C.)). EPA moved to dismiss that action, and we responded to that motion. The court has been notified of the Final Determination and on February 23, 2011 entered a scheduling order for summary disposition of the case.

**Clean Water Act Request for Information**

As described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, in January 2008, we received a request from the EPA for certain information related to compliance with effluent limitations and water quality standards under Section 308 of the Clean Water Act applicable to our eastern mining complexes located in West Virginia, Virginia and Kentucky. The request focuses on our compliance with water quality standards and effluent limitations at numerous outfalls as identified in the various NPDES permits applicable to our eastern mining complexes for the period beginning on January 1, 2003 through January 1, 2008. The compliance reporting mechanism is contained in Discharge Monitoring Reports which are required to be prepared and submitted quarterly to state environmental agencies and contain detailed monthly compliance data. In July 2008, the EPA referred the request to the U.S. Department of Justice. We negotiated a compromise with the Department of Justice, the EPA, the West Virginia Department of Environmental Protection and Kentucky Energy and Environment Cabinet to fully and finally resolve the issues identified in the EPA's Section 308 Request for Information. The compromise is contained in a consent decree which includes certain elements of injunctive relief and a penalty in the amount of \$4 million. The consent decree must be approved by the U.S. District Court for the Southern District of West Virginia before it becomes effective.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

In September 2006, our board of directors authorized a share repurchase program for the purchase of up to 14,000,000 shares of our common stock. There is no expiration date on the current authorization, and we have not made any decisions to suspend or cancel purchases under the program. As of March 31, 2011, there were 10,925,800 shares of our common stock available for purchase under this program. We did not purchase any shares of our common stock under this program during the quarter ended March 31, 2011. Based on the closing price of our common stock as reported on the New York Stock Exchange on May 2, 2011, the approximate dollar value of our common stock that may yet be purchased under this program was \$366.3 million.

**Item 3. Defaults Upon Senior Securities.**

None

**Item 4. Reserved.****Item 5. Other Information.****Mine Safety and Health Administration Safety Data**

We believe that Arch Coal is one of the safest coal mining companies in the world. Safety is a core value at Arch Coal and at our subsidiary operations. We have in place a comprehensive safety program that includes extensive health & safety training for all employees, site inspections, emergency response preparedness, crisis communications training, incident investigation, regulatory compliance training and process auditing, as well as an open dialogue between all levels of employees. The goals of our processes are to eliminate exposure to hazards in the workplace, ensure that we comply with all mine safety regulations, and support regulatory and industry efforts to improve the health and safety of our employees along with the industry as a whole.

Under the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act, each operator of a coal or other mine is required to include certain mine safety results in its periodic reports filed with the Securities and Exchange Commission. The operation of our mines is subject to regulation by the federal Mine Safety and Health Administration ( MSHA ) under the Federal Mine Safety and Health Act of 1977 (the Mine Act ). Below we present the following items regarding certain mine safety and health matters, broken down by mining complex owned and operated by Arch Coal or our subsidiaries, for the three-month period ended March 31, 2011:

*Section 104 Citations:* Total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of a coal or other mine safety or health hazard under section 104 of the Mine Act for which we have received a citation from MSHA;

*Section 104(b) Orders:* Total number of orders issued under section 104(b) of the Mine Act;  
28

---



**Table of Contents**

*Section 104(d) Citations/Orders:* Total number of citations and orders for unwarrantable failure of the mine operator to comply with mandatory health or safety standards under Section 104(d) of the Mine Act;

*Section 107(a) Orders:* Total number of imminent danger orders issued under section 107(a) of the Mine Act; and

*Total Dollar Value of Proposed MSHA Assessments:* Total dollar value of proposed assessments from MSHA under the Mine Act.

Mining complex(1)	Section	Section	Section	Section	Total Dollar Value of Proposed MSHA Assessments (in thousands)(2)
	104	104(b)	104(d)	107(a)	
	Citations	Orders	Citations/Orders	Orders	
<b>Power River Basin:</b>					
Black Thunder	4				\$ 4.6
Coal Creek	1				\$ 1.1
<b>Western Bituminous:</b>					
Arch of Wyoming	2				\$ 0
Dugout Canyon	3		1		\$ 0
Skyline	7				\$ 5.5
Sufco	3				\$ 4.5
West Elk	7				\$ 7.3
<b>Central Appalachia:</b>					
Coal-Mac	10				\$ 1.6
Cumberland River	23				\$ 23.2
Lone Mountain	37		3		\$ 39.7
Mountain Laurel	47		3		\$ 70.0
<b>Arch Coal Terminal</b>					\$ 0.2

(1) MSHA assigns an identification number to each coal mine and may or may not assign separate identification numbers to related facilities such as preparation plants. We are providing the information in this table by mining complex rather than MSHA identification number because we believe this format will be more useful to investors than providing information based on MSHA identification numbers. For descriptions of each of these mining operations please refer to the descriptions under Item 1. Business, in Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

(2) Amounts included under the heading "Total Dollar Value of Proposed MSHA Assessments" are the total dollar amounts for proposed assessments received from MSHA on or before April 15, 2011, for citations and orders occurring during the three-month period ended March 31, 2011.

For the three-month period ended March 31, 2011, none of our mining complexes received written notice from MSHA of (i) a flagrant violation under section 110(b)(2) of the Mine Act; (ii) a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of the Mine Act; or (iii) the potential to have such a pattern. For the three-month period ended March 31, 2011, none of our mining complexes experienced a mining-related fatality.

As of March 31, 2011, we had a total of ninety-eight matters pending before the Federal Mine Safety and Health Review Commission. This includes legal actions that were initiated prior to the three-month period ended March 31, 2011 and which do not necessarily relate to the citations, orders or proposed assessments issued by MSHA during such three-month period.

In evaluating the above information regarding mine safety and health, investors should take into account factors such as: (i) the number of citations and orders will vary depending on the size of a coal mine, (ii) the number of citations issued will vary from inspector to inspector and mine to mine, and (iii) citations and orders can be contested and appealed, and in that process are often reduced in severity and amount, and are sometimes dismissed.

**Table of Contents****Item 6. Exhibits.**

The following is a list of exhibits filed as part of this Quarterly Report on Form 10-Q:

Exhibit	Description
2.1	Agreement and Plan of Merger, dated as of May 2, 2011, by and among Arch Coal, Inc., Atlas Acquisition Corp. and International Coal Group, Inc. (incorporated herein by reference to Exhibit 2.1 to the registrant's Current Report on Form 8-K filed on May 3, 2011).
10.1	First Amendment to Amended and Restated Receivables Purchase Agreement, dated January 31, 2011, among Arch Receivable Company, LLC, Arch Coal Sales Company, Inc., and the other parties thereto (incorporated herein by reference to Exhibit 10.41 to the registrant's Annual Report on Form 10-K for the period ended December 31, 2010).
10.2	Tender and Voting Agreement by and among Arch Coal, Inc., Atlas Acquisition Corp. and certain stockholders of International Coal Group, Inc. (incorporated herein by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K filed on May 3, 2011).
10.3	Tender and Voting Agreement by and among Arch Coal, Inc., Atlas Acquisition Corp. and certain stockholders of International Coal Group, Inc. (incorporated herein by reference to Exhibit 10.2 to the registrant's Current Report on Form 8-K filed on May 3, 2011).
10.4	Debt Commitment Letter, dated as of May 2, 2011, by and among Morgan Stanley Senior Funding, Inc., PNC Bank, National Association, PNC Capital Markets LLC and Arch Coal, Inc. (incorporated herein by reference to Exhibit 10.3 to the registrant's Current Report on Form 8-K filed on May 3, 2011).
12.1	Computation of ratio of earnings to combined fixed charges and preference dividends.
31.1	Rule 13a-14(a)/15d-14(a) Certification of Steven F. Leer.
31.2	Rule 13a-14(a)/15d-14(a) Certification of John T. Drexler.
32.1	Section 1350 Certification of Steven F. Leer.
32.2	Section 1350 Certification of John T. Drexler.
101	Interactive Data File (Form 10-Q for the quarter ended March 31, 2011 furnished in XBRL). The financial information contained in the XBRL-related documents is unaudited and unreviewed and, in accordance with Rule 406T of Regulation S-T, is not deemed filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under these sections.

**Table of Contents**

**Signatures**

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

Arch Coal, Inc.

By: /s/ John T. Drexler  
John T. Drexler  
Senior Vice President and Chief Financial  
Officer

May 4, 2011

31