

ARCH COAL INC
Form 10-Q
August 09, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2011

o 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

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(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 ☐
(Do not check if a smaller reporting company)

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 August 4, 2011 there were 213,081,699 shares of the registrant's common stock outstanding.

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Part I

FINANCIAL INFORMATION

Item 1. Financial Statements.**Arch Coal, Inc. and Subsidiaries****Condensed Consolidated Statements of Income****(in thousands, except per share data)**

	Three Months Ended June 30		Six Months Ended June 30	
	2011	2010	2011	2010
	(unaudited)			
REVENUES				
Coal sales	\$ 985,087	\$ 764,295	\$ 1,858,025	\$ 1,476,169
COSTS, EXPENSES AND OTHER				
Cost of coal sales	709,953	570,861	1,363,637	1,121,611
Depreciation, depletion and amortization	95,183	87,759	178,720	176,278
Amortization of acquired sales contracts, net	1,489	5,214	7,433	15,967
Selling, general and administrative expenses	29,039	35,344	59,474	62,510
Change in fair value of coal derivatives and coal trading activities, net	2,672	4,587	888	10,464
Acquisition and transition costs related to ICG	48,666		48,666	
Gain on Knight Hawk transaction		(41,577)		(41,577)
Other operating income, net	(4,732)	(4,392)	(5,848)	(7,783)
	882,270	657,796	1,652,970	1,337,470
Income from operations	102,817	106,499	205,055	138,699
Interest expense, net:				
Interest expense	(42,249)	(35,125)	(76,829)	(70,208)
Interest income	755	623	1,501	961
	(41,494)	(34,502)	(75,328)	(69,247)
Other non-operating expense:				
Bridge financing costs related to ICG	(49,490)		(49,490)	
Net loss resulting from early retirement of ICG debt	(250)		(250)	
	(49,740)		(49,740)	
Income before income taxes	11,583	71,997	79,987	69,452
Provision for income taxes	186	5,723	12,716	4,948
Net income	11,397	66,274	67,271	64,504
Less: Net income attributable to noncontrolling interest	(318)	(118)	(591)	(144)
Net income attributable to Arch Coal, Inc.	\$ 11,079	\$ 66,156	\$ 66,680	\$ 64,360

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EARNINGS PER COMMON SHARE

Basic earnings per common share	\$	0.06	\$	0.41	\$	0.40	\$	0.40
Diluted earnings per common share	\$	0.06	\$	0.41	\$	0.39	\$	0.40
Basic weighted average shares outstanding		174,244		162,388		168,442		162,380
Diluted weighted average shares outstanding		175,272		163,130		169,554		163,105
Dividends declared per common share	\$	0.11	\$	0.10	\$	0.21	\$	0.19

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

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

	June 30, 2011	December 31, 2010
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 82,345	\$ 93,593
Restricted cash	350,966	
Trade accounts receivable	335,052	208,060
Other receivables	91,064	44,260
Inventories	350,201	235,616
Prepaid royalties	38,119	33,932
Deferred income taxes	7,015	
Coal derivative assets	12,780	15,191
Other	121,123	104,262
Total current assets	1,388,665	734,914
Property, plant and equipment, net	7,726,456	3,308,892
Other assets:		
Prepaid royalties	94,382	66,525
Goodwill	539,963	114,963
Deferred income taxes		361,556
Equity investments	207,646	177,451
Other	194,333	116,468
Total other assets	1,036,324	836,963
Total assets	\$ 10,151,445	\$ 4,880,769
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 286,437	\$ 198,216
Coal derivative liabilities	5,791	4,947
Deferred income taxes		7,775
Accrued expenses and other current liabilities	395,020	245,411
Current maturities of debt and short-term borrowings	428,610	70,997
Total current liabilities	1,115,858	527,346
Long-term debt	3,773,923	1,538,744
Asset retirement obligations	412,324	334,257
Accrued pension benefits	36,047	49,154
Accrued postretirement benefits other than pension	87,626	37,793
Accrued workers' compensation	65,027	35,290
Deferred income taxes	863,970	
Other noncurrent liabilities	258,261	110,234
Total liabilities	6,613,036	2,632,818
Redeemable noncontrolling interest	11,032	10,444
Stockholders' equity:		
Common stock, \$0.01 par value, authorized 260,000 shares, issued 212,312 shares and 164,117 shares, respectively	2,127	1,645
Paid-in capital	2,991,550	1,734,709

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Treasury stock, 1,512 shares at June 30, 2011 and December 31, 2010, at cost	(53,848)	(53,848)
Retained earnings	593,896	561,418
Accumulated other comprehensive loss	(6,348)	(6,417)
Total stockholders' equity	3,527,377	2,237,507
Total liabilities and stockholders' equity	\$ 10,151,445	\$ 4,880,769

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

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Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

	Six Months Ended June 30	
	2011	2010
	(unaudited)	
OPERATING ACTIVITIES		
Net income	\$ 67,271	\$ 64,504
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, depletion and amortization	178,720	176,278
Amortization of acquired sales contracts, net	7,433	15,967
Bridge financing costs related to ICG	49,490	
Net loss resulting from early retirement of ICG debt	250	
Write down of assets acquired from ICG	7,316	
Prepaid royalties expensed	19,491	16,048
Employee stock-based compensation expense	7,071	7,439
Amortization of debt financing costs	5,093	4,901
Gain on Knight Hawk transaction		(41,577)
Changes in:		
Receivables	(25,329)	(44,057)
Inventories	(37,113)	2,458
Coal derivative assets and liabilities	4,902	11,631
Accounts payable, accrued expenses and other current liabilities	8,912	32,060
Income taxes, net	(15,186)	(309)
Deferred income taxes	20,873	(4,719)
Other	15,006	18,731
Cash provided by operating activities	314,200	259,355
INVESTING ACTIVITIES		
Acquisition of ICG, net of cash acquired	(2,910,380)	
Change in restricted cash	(74,814)	
Capital expenditures	(107,725)	(171,958)
Proceeds from dispositions of property, plant and equipment	1,411	229
Purchases of investments and advances to affiliates	(38,059)	(14,249)
Additions to prepaid royalties	(25,212)	(23,466)
Cash used in investing activities	(3,154,779)	(209,444)
FINANCING ACTIVITIES		
Proceeds from the issuance of senior notes	2,000,000	
Proceeds from the issuance of common stock, net	1,249,407	
Payments to retire ICG debt	(307,984)	
Increase in restricted cash for retirement of ICG debt	(260,663)	
Net increase (decrease) in borrowings under lines of credit and commercial paper program	303,096	(15,555)
Net payments on other debt	(8,845)	(8,249)
Debt financing costs	(112,334)	(437)
Dividends paid	(34,192)	(30,870)
Issuance of common stock under incentive plans	846	137
Contribution from noncontrolling interest		891

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Cash provided by (used in) financing activities	2,829,331	(54,083)
Decrease in cash and cash equivalents	(11,248)	(4,172)
Cash and cash equivalents, beginning of period	93,593	61,138
Cash and cash equivalents, end of period	\$ 82,345	\$ 56,966

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

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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. On June 15, 2011, the Company acquired International Coal Group, Inc. (ICG), as described in Note 3, Business Combinations. The Company operates 24 mining complexes in West Virginia, Kentucky, Maryland, Virginia, Illinois, 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 and six month periods ended June 30, 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

There is no new accounting guidance that is expected to have a significant impact on the Company's financial statements.

3. Business Combination

On June 15, 2011, the Company completed its acquisition of ICG, a leading coal producer, operating 12 mining complexes in Appalachia and one complex in the Illinois basin. In addition, a mine is currently under development in Appalachia. The Company acquired all of ICG's outstanding shares of common stock for \$3.1 billion. To finance the acquisition, the Company received net proceeds of \$1.25 billion from the sale of 48.0 million shares of its common stock and issued \$2.0 billion in aggregate principal amount of senior unsecured notes. See Note 4,

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Equity Offering and Note 5, Debt and Financing Arrangements for further information about these transactions.

The Company has not finalized the determination of the fair values of the assets acquired and liabilities assumed in the acquisition. The following table summarizes the consideration paid for ICG and the estimated amounts of assets acquired and liabilities assumed that were recognized at the acquisition date:

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	(in millions)
Consideration paid, net of cash acquired	\$ 2,910.4
Recognized amounts of net tangible and intangible assets acquired and liabilities assumed:	
Restricted cash	15.5
Receivables	114.2
Inventories	77.5
Net property, plant and equipment, including mineral rights	4,516.4
Goodwill	425.0
Other assets	49.2
Accounts payable	(82.4)
Other accrued expenses and current liabilities	(53.0)
Executive change in control payments	(10.0)
Debt	(604.8)
Litigation accrual	(105.3)
Accrued postretirement benefits	(49.4)
Asset retirement obligation	(80.4)
Coal supply agreements, net	(77.7)
Deferred income taxes, net	(1,189.9)
Other	(34.5)
Net tangible and intangible assets acquired	\$ 2,910.4

Because the Company's valuation efforts are ongoing, the preliminary fair values above could change substantially. Notably, the assigned value of goodwill was calculated as the present value of the estimated synergies from the acquisition and the fair value of the coal reserves acquired has not yet been determined and will involve estimating the amounts and timing of cash flows from the properties acquired.

The allocation of goodwill to reporting units will not be completed until the valuation process is completed. Any goodwill related to the acquisition is not expected to be deductible for tax purposes.

The revenues and income before income taxes related to the acquired operations that have been included in the consolidated statements of income since the date of acquisition were \$48.0 million and \$11.9 million, respectively.

The following unaudited pro forma information has been prepared for illustrative purposes and assumes that the business combination occurred on January 1, 2010. The unaudited pro forma results have been prepared based upon ICG's historical results and estimates of the ongoing effects of the transactions that the Company believes are reasonable and supportable. The results are not necessarily reflective of the consolidated results of operations had the acquisition actually occurred on January 1, 2010, nor are they indicative of future operating results.

The unaudited supplemental pro forma financial information of the combined entity follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2011	2010	2011	2010
	((In thousands))			
Total revenues				
As reported	\$ 985.1	\$ 764.3	\$ 1,858.0	\$ 1,476.2

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Pro forma	\$	1,233.9	\$	1,044.0	\$	2,397.7	\$	2,035.8
Income (loss) before income taxes								
As reported	\$	11.6	\$	72.0	\$	80.0	\$	69.5
Pro forma	\$	62.0	\$	(67.8)	\$	74.9	\$	(86.2)

The pro forma income before income taxes reflects adjustments to depreciation, depletion and amortization for the new basis in assets acquired and interest expense to reflect the debt incurred to finance the acquisition. In addition, the following costs and expenses

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reflected in the income before income taxes for the six month period ended June 30, 2011 reported in the condensed consolidated statement of operations are reversed out of 2011 and reflected in 2010 in the pro forma results.

Costs of affecting the acquisition - Arch	\$	27,852
Costs of affecting the acquisition - ICG		23,503
Severance costs		13,498
Write off of acquired assets		7,316
Bridge financing fees		49,490
	\$	121,659

Severance costs represent both change in control payments to executives and severance for employees terminated after the acquisition. Additional severance costs of \$3.4 million are expected to be incurred in the remainder of 2011. The acquired asset write-off relates to a preparation plant and loadout of an acquired ICG mining operation. The acquired operation has been combined with an existing operation of the Company, and will utilize an existing facility.

Anticipated synergies are not reflected in the pro forma results.

In conjunction with the acquisition, the Company has \$351.0 million of restricted cash at June 30, 2011 to discharge the Company's obligation under certain ICG debt, to provide collateral for ICG letters of credit until they can be eliminated or replaced and to fund executive change in control payments. See further discussion of the ICG debt in Note 5, Debt.

4. Equity Offering

On June 8, 2011, the Company sold 48 million shares of its common stock at a public offering price of \$27.00 per share. The \$1.25 million in net proceeds from the issuance were used to finance the acquisition. On July 8, 2011, the Company issued an additional 0.7 million shares of its common stock under the same terms and conditions to cover underwriters' over-allotments for net proceeds of \$18.4 million.

5. Debt

	June 30, 2011	December 31, 2010
	(In thousands)	
Commercial paper	\$	\$ 56,904
7.00% senior notes due June 15, 2019 at par	1,000,000	
7.25% senior notes due June 15, 2021 at par	1,000,000	
Indebtedness to banks under credit facilities	360,000	
9.125% senior notes (\$200.0 million face value) due April 1, 2018	250,000	
4.00% convertible senior notes (\$16.5 million face value) due April 1, 2017	42,902	

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9.00% convertible senior notes (\$18 thousand face value) due August 1, 2012	44	
6.75% senior notes (\$450.0 million face value) due July 1, 2013	451,294	451,618
8.75% senior notes (\$600.0 million face value) due August 1, 2016	588,029	587,126
7.25% senior notes due October 1, 2020 at par	500,000	500,000
Other	10,264	14,093
	4,202,533	1,609,741
Less current maturities of debt and short-term borrowings	428,610	70,997
Long-term debt	\$ 3,773,923	\$ 1,538,744

The current maturities of debt include contractual maturities, as well as amounts borrowed that are supported by credit facilities that have a term of less than one year and amounts borrowed under credit facilities with terms longer than one year that the Company does not intend to refinance on a long-term basis, based on cash projections and management's plans. In addition, the current maturities at June 30, 2011 include the ICG debt that the Company redeemed in the third quarter. See further discussion in "ICG Debt" below.

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2019 and 2021 Senior Notes

On June 14, 2011, the Company entered into an indenture in conjunction with the issuance of the 7.00% senior notes due 2019 (2019 Notes) and the 7.25% senior notes due 2021 (2021 Notes) as discussed in Note 3, Business Combinations. Interest is payable on the 2019 Notes and 2021 Notes on June 15 and December 15 of each year, commencing December 15, 2011.

At any time prior to June 15, 2014, the Company may redeem up to 35% of the aggregate principal amount of each of the 2019 Notes and 2021 Notes, plus accrued and unpaid interest, with the net proceeds from certain equity offerings. The Company may redeem the 2019 Notes prior to June 15, 2015 and the 2021 Notes prior to June 15, 2016 at the respective make-whole prices set forth in the indenture. On or after June 15, 2015, the Company may redeem the 2019 Notes for cash at redemption prices, reflected as a percentage of the principal amount, of: 103.5% from June 15, 2015 through June 14, 2016; 101.75% from June 15, 2016 through June 14, 2017; and 100% beginning on June 15, 2017. On or after June 15, 2016, the Company may redeem the 2021 Notes for cash at redemption prices, reflected as a percentage of the principal amount, of: 103.625% from June 15, 2016 through June 14, 2017; 102.417% from June 15, 2017 through June 14, 2018; 101.208% from June 15, 2018 through June 14, 2019 and 100% beginning on June 15, 2019. In each case, accrued and unpaid interest at the redemption date is due upon redemption. Upon a change in control, the Company is required to make a tender offer for both series of notes at a price of 101% of the principal amount.

The 2019 Notes and 2021 Notes are guaranteed by substantially all of the Company's subsidiaries, including the newly acquired subsidiaries of ICG and excluding Arch Western, its subsidiaries and Arch Receivable Company, LLC. The Company incurred financing fees of \$44.2 million related to the issuance of these notes.

The Company and the guarantor subsidiaries entered into a registration rights agreement (the Registration Rights Agreement) in connection with the 2019 Notes and 2021 Notes. Pursuant to the Registration Rights Agreement, the Company and the guarantor subsidiaries agreed to file a registration statement with the Securities and Exchange Commission to exchange a like aggregate principal amount of senior notes identical in all material respects to the 2019 Notes and 2021 Notes. Pursuant to the Registration Rights Agreement, the Company must make reasonable best efforts to cause the registration statement to become effective by June 13, 2012. Should those events not occur within the specified time frame, the interest rate shall be increased by one-quarter of one percent per annum for the first 90 days following such period. Such interest rate will increase by an additional one-quarter of one percent per annum thereafter up to a maximum aggregate increase of one percent per annum. Once any of the required events occur, the interest rate will revert to the rate specified in the indenture.

ICG Debt

Upon the closing of the ICG acquisition, the Company gave a 30-day redemption notice to the Trustee of ICG's 9.125% senior notes and legally discharged our obligation under the 9.125% senior notes by depositing the funds to redeem the debt with the Trustee. The \$260.7 million balance deposited is reflected in restricted cash on the accompanying condensed consolidated balance sheet at June 30, 2011. On July 14, 2011, all of the outstanding 9.125% senior notes were redeemed at an aggregate price of \$251.4 million, including the required make-whole premium, plus accrued interest of \$5.2 million.

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At the acquisition date, ICG's 4.00% convertible senior notes with a fair value of \$298.5 million and 9.00% convertible senior notes with a fair value of \$1.7 million (convertible notes) became convertible into cash, pursuant to the amended indentures governing the convertible notes, at a calculated conversion rate of \$2,614.6848 for each \$1,000 in principal amount surrendered for conversion for the 4.00% convertible notes and \$2,392.73414 for the 9.00% convertible notes. As of July 31, 2011, the aggregate conversion value of the remaining convertible notes outstanding was \$4.5 million.

Other ICG debt, with a fair value of approximately \$54.0 million at the acquisition date, consisted mainly of individually insignificant equipment notes and insurance notes payable. The remaining balance of other ICG debt was \$5.2 million at June 30, 2011.

The Company recognized a net loss of approximately \$0.3 million on the early extinguishment of ICG's debt, including the conversions of the 4.00% and 9.00% convertible notes described above.

Credit Facilities and Commercial Paper

On June 14, 2011, the Company amended and restated its secured credit facility to allow for up to \$2.0 billion in borrowings. Borrowings under this credit facility bear interest at a floating rate based on LIBOR determined by reference to the Company's leverage ratio, as calculated in accordance with the credit agreement. The credit facility has a five-year term that expires on June 14, 2016 and is secured by substantially all of the Company's assets as well as its ownership interests in substantially all of its subsidiaries, excluding its ownership interests in Arch Western and its subsidiaries. Commitment fees of 0.50% per annum are payable on the average unused daily

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balance of the revolving credit facility. The Company paid and deferred \$20.7 million in financing fees related to the amendment of this agreement. Financial covenant requirements may restrict the amount of unused capacity available to the Company for borrowings and letters of credit.

On June 14, 2011, the Company terminated its commercial paper placement program and the supporting credit facility.

Availability

As of June 30, 2011 the Company had \$360.0 million of borrowings outstanding under the amended revolving credit facility. The revolving credit facility contains customary financial covenants that limit the Company's total debt based on defined earnings measurements. As of June 30, 2011, the Company had availability of approximately \$1.1 billion under all lines of credit, as limited by these covenants. The Company also had outstanding letters of credit of \$76.2 million as of June 30, 2011.

6. Acquired Sales Contracts

Coal supply agreements (sales contracts) acquired in a business combination are capitalized at their fair value and amortized over the tons of coal shipped during the term of the contract. The fair value of a sales contract is determined by discounting the cash flows attributable to the difference between the contract price and the prevailing forward prices for the tons under contract at the date of acquisition. Below are the acquired sales contracts reflected in the condensed consolidated balance sheets:

	June 30, 2011	December 31, 2010
	(In thousands)	
Location in Balance Sheet		
Other current assets	\$ 35,496	\$ 25,063
Other assets	24,622	7,014
Total	60,118	32,077
Accrued expenses and other current liabilities	(80,411)	(5,615)
Other noncurrent liabilities	(58,787)	(20,426)
Total	(139,198)	(26,041)
Net total	\$ (79,080)	\$ 6,036

Above-market contracts with a preliminary fair value of \$43.3 million and below-market contracts with a preliminary fair value of \$121.0 million were acquired from ICG. Of these amounts, \$22.7 million and \$75.4 million were classified as current assets and current liabilities, respectively, at the acquisition date.

The Company anticipates amortization income of all acquired sales contracts, based upon the preliminary fair value assigned to acquired ICG sales contracts and expected shipments in the next five years, to be approximately \$41 million for the remainder of 2011, \$10 million in 2012, \$6

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million in 2013, \$9 million in 2014 and \$13 million in 2015.

7. Investments

	Knight Hawk	DKRW	DTA	Tenaska	Millennium	Total
	(In thousands)					
Balance at December 31, 2010	\$ 131,250	\$ 21,961	\$ 14,472	\$ 9,768	\$ 25,570	\$ 177,451
Investments in affiliates			2,910	5,500		33,980
Advances to (distributions from) affiliates, net	(9,591)					(9,591)
Equity in comprehensive income (loss)	9,981	(1,079)	(2,207)	(2)	(887)	5,806
Balance at June 30, 2011	\$ 131,640	\$ 20,882	\$ 15,175	\$ 15,266	\$ 24,683	\$ 207,646
Notes receivable from investees:						
Balance at December 31, 2010	\$ 1,700	\$ 18,100	\$	\$ 4,100	\$	\$ 23,900
Balance at June 30, 2011		24,700		4,600		29,300

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

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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.

The Company may be required to make future contingent payments of up to \$70.9 million related to development financing for certain of its equity investees. The Company's 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 construction financing.

8. 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 75 to 85 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 June 30, 2011, the Company had protected the price of approximately 70% of its expected purchases for the remainder of fiscal year 2011 and 41% for fiscal year 2012.

At June 30, 2011, the Company held heating oil swaps and purchased call options for approximately 66.8 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.

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 June 30, 2011, the Company held derivatives for risk management purposes totaling 1.3 million tons of coal sales and 0.6 million tons of coal purchases that are expected to settle during the remainder of 2011, 1.3 million tons of coal sales and 0.2 million tons of coal purchases that are expected to settle in 2012, 0.7 million tons of coal sales that are expected to settle in 2013, 1.4 million tons of coal sales that are expected to settle in 2014 and 0.7 million tons of coal sales that are expected to settle in 2015.

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

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realization of the value of the trading portfolio is 50% for the remainder of 2011 and 50% in 2012.

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)

	June 30, 2011		December 31, 2010	
	Asset	Liability	Asset	Liability
	Derivative	Derivative	Derivative	Derivative
Derivatives Designated as Hedging Instruments				
Heating oil	\$ 18,101	\$	\$ 13,475	\$
Coal	3,273	(1,924)	2,009	(2,350)
Total	21,374	(1,924)	15,484	(2,350)
Derivatives Not Designated as Hedging Instruments				
Coal held for trading purposes	18,780	(9,788)	34,445	(24,087)
Coal	1,352	(4,704)	1,139	(912)
Total	20,132	(14,492)	35,584	(24,999)
Total derivatives	41,506	(16,416)	51,068	(27,349)
Effect of counterparty netting	(10,625)	10,625	(22,402)	22,402
Net derivatives as classified in the balance sheets	\$ 30,881	\$ (5,791)	\$ 25,090	\$ (4,947)
				\$ 23,719

Net derivatives as reflected on the balance sheets

	June 30, 2011	December 31, 2010
Heating oil	Other current assets \$ 18,101	\$ 13,475
Coal	Coal derivative assets 12,780	15,191
	Coal derivative liabilities (5,791)	(4,947)
	\$ 25,090	\$ 23,719

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The Company had a current asset for the right to reclaim cash collateral of \$9.2 million and \$10.3 million at June 30, 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 June 30

(in thousands)

Derivatives used in Cash Flow Hedging Relationships	Gain (Loss) Recognized in OCI (Effective Portion)		Gains (Losses) Reclassified from OCI into Income (Effective Portion)		Gain (Loss) Recognized in Income (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
	2011	2010	2011	2010	2011	2010
Heating oil	\$ (6,337)	\$ (8,572)	\$ 6,654(2)	\$ 1,925(2)	\$	\$
Coal sales	1,344	(7,237)	237(1)	(1,201)(1)		
Coal purchases	97	7,167	(2)	(2)		
Totals	\$ (4,896)	\$ (8,642)	\$ 6,891	\$ 724	\$	\$

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Derivatives Not Designated as Hedging Instruments	Gain (Loss)	
	2011	2010
Coal unrealized	\$ (374)(3)	\$ (3,466)(3)
Coal realized	\$ 147(4)	\$ 1,252(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

During the three months ended June 30, 2011 and 2010, the Company recognized net unrealized and realized losses of \$2.3 million and \$1.1 million, respectively, 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.

Six Months Ended June 30

(in thousands)

Derivatives used in Cash Flow Hedging Relationships	Gain (Loss) Recognized in OCI (Effective Portion)		Gains (Losses) Reclassified from OCI into Income (Effective Portion)		Gain (Loss) Recognized in Income (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
	2011	2010	2011	2010	2011	2010
Heating oil	\$ 7,921	\$ (8,560)	\$ 9,824(2)	\$ (304)(2)	\$	\$
Coal sales	2,750	(7,638)	324(1)	(1,330)(1)		
Coal purchases	(779)	8,069	(2)	(336)(2)		
Totals	\$ 9,892	\$ (8,129)	\$ 10,148	\$ (1,970)	\$	\$

Derivatives Not Designated as Hedging Instruments	Gain (Loss)	
	2011	2010
Coal unrealized	\$ (1,419)(3)	\$ (8,388)(3)
Coal realized	\$ 147(4)	\$ 2,852(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 \$0.5 million during the six months ended June 30, 2011 and net unrealized and realized losses of \$2.1 million during the six months ended June 30, 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 June 30, 2011, gains on derivative contracts designated as hedge instruments in cash flow hedges of approximately \$17.9 million are expected to be reclassified from other comprehensive income into earnings.

9. Inventories

Inventories consist of the following:

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	June 30, 2011	December 31, 2010
	(In thousands)	
Coal	\$ 189,989	\$ 115,647
Repair parts and supplies, net of allowance	160,212	119,969
	\$ 350,201	\$ 235,616

The repair parts and supplies are stated net of an allowance for slow-moving and obsolete inventories of \$13.1 million at June 30, 2011, and \$12.7 million at December 31, 2010.

10. 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:

	Total	Fair Value at June 30, 2011		Level 3
		Level 1	Level 2	
		(In thousands)		
Assets:				
Investments in equity securities	\$ 6,335	\$ 6,319	\$	\$ 16
Derivatives	30,881	6,233	10,054	14,594

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Total assets	\$	37,216	\$	12,552	\$	10,054	\$	14,610
Liabilities:								
Derivatives	\$	5,791	\$		\$	1,655	\$	4,136

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 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.

	Three Months Ended June 30, 2011	Six Months Ended June 30, 2011
	(In thousands)	
Balance, beginning of period	\$ 15,781	\$ 9,183
Realized and unrealized losses recognized in earnings	(4,545)	(7,124)
Realized and unrealized gains (losses) recognized in other comprehensive income	(5,453)	3,475
Purchases	9,006	10,472
Issuances	(2,160)	(2,160)
Settlements	(2,155)	(3,372)
Balance, end of period	\$ 10,474	\$ 10,474

Net unrealized losses during the three and six month periods ended June 30, 2011 related to level 3 financial instruments held on

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June 30, 2011 were \$8.3 million and \$3.5 million, respectively.

Fair Value of Long-Term Debt

At June 30, 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 \$4.3 billion and \$1.7 billion, respectively. Fair values are based upon observed prices in an active market when available or from valuation models using market information.

11. Stock-Based Compensation and Other Incentive Plans

During the six months ended June 30, 2011, the Company granted options to purchase approximately 0.7 million shares of common stock with a weighted average exercise price of \$32.50 per share and a weighted average grant-date fair value of \$14.38 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 six months ended June 30, 2011 at a weighted average grant-date fair value of \$32.49 per share. The restricted stock vests after three years.

During the six months ended June 30, 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 \$8.6 million and \$6.4 million as of June 30, 2011 and December 31, 2010, respectively.

The Company recognized compensation expense from all stock-based and LTI plans of \$2.4 million and \$5.0 million for the three months ended June 30, 2011 and 2010, respectively. The Company recognized compensation expense from all stock-based and LTI plans of \$9.2 million and \$8.8 million for the six months ended June 30, 2011 and 2010, respectively. These expenses are primarily included in selling, general and administrative expenses in the accompanying condensed consolidated statements of income.

12. Workers' Compensation Expense

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

Three Months Ended June 30

Six Months Ended June 30

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	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Self-insured occupational disease benefits:				
Service cost	\$ 246	\$ 208	\$ 439	\$ 363
Interest cost	304	194	558	338
Net amortization	(160)	(382)	(261)	(930)
Total occupational disease	390	20	736	(229)
Traumatic injury claims and assessments	3,324	2,244	5,649	3,920
Total workers compensation expense	\$ 3,714	\$ 2,264	\$ 6,385	\$ 3,691

13. Employee Benefit Plans

The following table details the components of pension benefit costs:

	Three Months Ended June 30		Six Months Ended June 30	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Service cost	\$	3,926	\$	4,062
Interest cost		3,996		3,790
Expected return on plan assets		(5,438)		(5,530)
Amortization of prior service cost		(142)		43
Amortization of other actuarial losses		2,235		1,161
Net benefit cost	\$	4,577	\$	3,526

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

	Three Months Ended June 30		Six Months Ended June 30	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Service cost	\$ 518	\$ 308	\$ 923	\$ 754
Interest cost	529	394	1,027	1,042
Amortization of prior service credits	(546)	(679)	(1,137)	(1,182)
Amortization of other actuarial gains	(952)	(989)	(1,550)	(1,459)
Net benefit credit	\$ (451)	\$ (966)	\$ (737)	\$ (845)

14. 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:

	Three Months Ended June 30		Six Months Ended June 30	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Net income attributable to Arch Coal, Inc.	\$ 11,079	\$ 66,156	\$ 66,680	\$ 64,360
Other comprehensive income, net of income taxes:				
Pension, postretirement and other post-employment benefits, reclassifications into net income	293	(536)	866	56
Unrealized losses on available-for-sale securities	(1,434)	(925)	(687)	(916)
Unrealized gains and losses on derivatives, net of reclassifications into net income:				
Unrealized gains (losses) on derivatives	(3,127)	(5,451)	6,374	(5,089)
Reclassifications of (gains) losses into net income	(4,360)	(506)	(6,484)	1,217
Total comprehensive income	\$ 2,451	\$ 58,738	\$ 66,749	\$ 59,628

15. Earnings per Common Share

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

	Three Months Ended June 30		Six Months Ended June 30	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Weighted average shares outstanding:				

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Basic weighted average shares outstanding	174,244	162,388	168,442	162,380
Effect of common stock equivalents under incentive plans	1,028	742	1,112	725
Diluted weighted average shares outstanding	175,272	163,130	169,554	163,105

The effect of options to purchase 2.3 million and 2.4 million shares of common stock were excluded from the calculation of diluted weighted average shares outstanding for the three month periods ended June 30, 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 effect of options to purchase 1.7 million and 2.4 million shares of common stock were excluded from the calculation of diluted weighted average shares outstanding for the six month periods ended June 30, 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.

16. 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. Patriot Coal Corporation (Patriot) acquired Magnum in July 2008. 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.

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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. As of June 30, 2011, Patriot has replaced \$48.9 million of the surety bonds and has posted letters of credit of \$32.7 million in the Company's favor. At June 30, 2011, the Company had \$38.5 million of surety bonds remaining 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.

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 June 30, 2011, the cost of purchasing 10.7 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 \$368.2 million, and the cost of purchasing 1.1 million tons of coal to supply the assigned and guaranteed contracts over their duration would exceed the sales price under the contracts by approximately \$23.8 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 June 30, 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 \$25.3 million at June 30, 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.

17. Contingencies

On June 15, 2011, we acquired ICG and its subsidiaries. The following matters related to certain claims and legal actions involving ICG and/or its subsidiaries.

Allegheny Energy Supply (Allegheny), the sole customer of coal produced at the Company's subsidiary Wolf Run Mining Company's (Wolf Run) Sycamore No. 2 mine, filed a lawsuit against Wolf Run, Hunter Ridge Holdings, Inc. (Hunter Ridge), and ICG in state court in Allegheny County, Pennsylvania on December 28, 2006, and amended its complaint on April 23, 2007. Allegheny claimed that Wolf Run breached a coal supply contract when it declared force majeure under the contract upon idling the Sycamore No. 2 mine in the third quarter of 2006, and that Wolf Run continued to breach the contract by failing to ship in volumes referenced in the contract. The Sycamore No. 2 mine was idled after encountering adverse geologic conditions and abandoned gas wells that were previously unidentified and unmapped. After extensive searching for gas wells and rehabilitation of the mine, it was re-opened in 2007, but with notice to Allegheny that it would necessarily operate at reduced volumes in order to safely and effectively avoid the many gas wells within the reserve. The amended complaint also alleged that the production stoppages constitute a breach of the guarantee agreement by Hunter Ridge and breach of certain representations made upon entering into the contract in early 2005. Allegheny voluntarily dropped the breach of representation claims later. Allegheny claimed that it would incur costs in

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excess of \$100 million to purchase replacement coal over the life of the contract. ICG, Wolf Run and Hunter Ridge answered the amended complaint on August 13, 2007, disputing all of the remaining claims.

On November 3, 2008, ICG, Wolf Run and Hunter Ridge filed an amended answer and counterclaim against the plaintiffs seeking to void the coal supply agreement due to, among other things, fraudulent inducement and conspiracy. On September 23, 2009, Allegheny filed a second amended complaint alleging several alternative theories of liability in its effort to extend contractual liability to ICG, which was not a party to the original contract and did not exist at the time Wolf Run and Allegheny entered into the contract. No new substantive claims were asserted. ICG answered the second amended complaint on October 13, 2009, denying all of the new claims. The Company's counterclaim was dismissed on motion for summary judgment entered on May 11, 2010. Allegheny's claims

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against ICG were also dismissed by summary judgment, but the claims against Wolf Run and Hunter Ridge were not. The court conducted a non-jury trial of this matter beginning on January 10, 2011 and concluding on February 1, 2011. At the trial, Allegheny presented its evidence for breach of contract and claimed that it is entitled to past and future damages in the aggregate of between \$228.0 million and \$377.0 million. Wolf Run and Hunter Ridge presented their defense of the claims, including evidence with respect to the existence of force majeure conditions and excuse under the contract and applicable law. Wolf Run and Hunter Ridge presented evidence that Allegheny's damages calculations were significantly inflated because it did not seek to determine damages as of the time of the breach and in some instances artificially assumed future non-delivery or did not take into account the apparent requirement to supply coal in the future. On May 2, 2011, the trial court entered a Memorandum and Verdict determining that Wolf Run had breached the coal supply contract and that the performance shortfall was not excused by force majeure. The trial court awarded total damages and interest in the amount of \$104.1 million. ICG and Allegheny have filed post-verdict motions in the trial court. The court's judgment on those motions is expected to be issued soon, after which the Company expects to appeal to the Pennsylvania appellate court, if necessary. No appeal bond is necessary while post-verdict motions are pending with the trial court, but an appeal bond equal to the damages assessed may have to be posted in the future.

As of June 30, 2011, the Company has accrued \$104.1 million for this lawsuit, representing the fair value of the judgment at the acquisition date. The ultimate resolution of this matter could result in an outcome which may be materially different than what the Company has accrued.

In addition, 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, other than as noted above, will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company.

18. Segment Information

The Company has three reportable business segments, which are based on the major coal producing 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 characteristic to 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 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; the Appalachia (APP) segment, with operations in West Virginia, Kentucky, Maryland and Virginia. The Appalachia segment includes the acquired ICG operations in Appalachia, as well as the Company's previous Central Appalachia segment. The Other operating segment represents primarily the Company's Illinois operations and ADDCAR subsidiary, which manufactures and sells its patented highwall mining system.

Operating segment results for the three and six months ended June 30, 2011 and 2010 are presented below. Results for the reportable 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.

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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 unassigned coal reserves, above-market acquired sales contracts and other unassigned assets.

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	PRB	APP	WBIT	Other Operating Segments	Corporate, Other and Eliminations	Consolidated
	(In thousands)					
Three months ended June 30, 2011						
Coal sales	\$ 391,413	\$ 400,792	\$ 189,154	\$ 3,728	\$	\$ 985,087
Income from operations	35,615	97,876	43,672	317	(74,663)	102,817
Depreciation, depletion and amortization	41,165	31,025	22,099	605	289	95,183
Amortization of acquired sales contracts, net	5,603	(4,123)		9		1,489
Capital expenditures	15,647	29,288	10,115	4,328	9,636	69,014
Three months ended June 30, 2010						
Coal sales	\$ 370,499	\$ 261,646	\$ 132,150	\$	\$	\$ 764,295
Income from operations	33,177	54,079	13,876		5,367	106,499
Depreciation, depletion and amortization	44,433	24,581	18,390		355	87,759
Amortization of acquired sales contracts, net	5,214					5,214
Capital expenditures	3,725	12,972	20,703		102,583	139,983
Six months ended June 30, 2011						
Coal sales	\$ 784,526	\$ 725,178	\$ 344,593	\$ 3,728	\$	\$ 1,858,025
Income from operations	82,489	152,270	70,564	317	(100,585)	205,055
Total assets	2,212,818	5,208,551	679,231	217,765	1,833,080	10,151,445
Depreciation, depletion and amortization	82,856	52,041	42,628	605	590	178,720
Amortization of acquired sales contracts, net	11,547	(4,123)		9		7,433
Capital expenditures	18,485	46,590	21,892	4,373	16,385	107,725
Six months ended June 30, 2010						
Coal sales	\$ 729,914	\$ 481,392	\$ 264,863	\$	\$	\$ 1,476,169
Income from operations	49,738	91,672	26,306		(29,017)	138,699
Total assets	2,331,449	725,588	682,565		1,150,938	4,890,540
Depreciation, depletion and amortization	89,054	47,755	38,760		709	176,278
Amortization of acquired sales contracts, net	15,967					15,967
Capital expenditures	4,450	24,609	33,804		109,095	171,958

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

	Three Months Ended June 30		Six Months Ended June 30	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Income from operations	\$ 102,817	\$ 106,499	\$ 205,055	\$ 138,699
Interest expense	(42,249)	(35,125)	(76,829)	(70,208)

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Interest income	755	623	1,501	961
Bridge financing costs related to ICG	(49,490)		(49,490)	
Net loss resulting from early retirement of ICG debt	(250)		(250)	
Income before income taxes	\$ 11,583	\$ 71,997	\$ 79,987	\$ 69,452

19. 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 June 30, 2011****(unaudited)**

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Revenue					
Coal sales	\$	\$ 419,454	\$ 565,633	\$	\$ 985,087
Costs, expenses and other					
Cost of coal sales	4,940	282,535	447,707	(25,229)	709,953
Depreciation, depletion and amortization	659	54,008	40,516		95,183
Amortization of acquired sales contracts, net		(4,113)	5,602		1,489
Selling, general and administrative expenses	18,600	3,170	9,104	(1,835)	29,039
Change in fair value of coal derivatives and coal trading activities, net		2,672			2,672
Acquisition and transition costs related to ICG	48,666				48,666
Other operating (income) expense, net	(4,831)	(29,687)	2,722	27,064	(4,732)
	68,034	308,585	505,651		882,270
Income from investment in subsidiaries	172,831			(172,831)	
Income from operations	104,797	110,869	59,982	(172,831)	102,817
Interest income (expense), net:					
Interest expense	(47,824)	(1,924)	(10,962)	18,461	(42,249)
Interest income	4,100	135	14,981	(18,461)	755
	(43,724)	(1,789)	4,019		(41,494)
Other non-operating expense:					
Bridge financing costs related to ICG	(49,490)				(49,490)
Net loss resulting from early retirement of ICG debt		(250)			(250)
	(49,490)	(250)			(49,740)
Income before income taxes	11,583	108,830	64,001	(172,831)	11,583
Provision for income taxes	186				186
Net income	11,397	108,830	64,001	(172,831)	11,397
Less: Net income attributable to noncontrolling interest	(318)				(318)
Net income attributable to Arch Coal	\$ 11,079	\$ 108,830	\$ 64,001	\$ (172,831)	\$ 11,079

Table of Contents**Condensed Consolidating Statements of Income****Three Months Ended June 30, 2010****(unaudited)**

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Revenue					
Coal sales	\$	\$ 282,817	\$ 481,478	\$	\$ 764,295
Costs, expenses and other					
Cost of coal sales	2,148	193,243	396,568	(21,098)	570,861
Depreciation, depletion and amortization	725	46,941	40,093		87,759
Amortization of acquired sales contracts, net			5,214		5,214
Selling, general and administrative expenses	23,251	1,836	12,006	(1,749)	35,344
Change in fair value of coal derivatives and coal trading activities, net		4,587			4,587
Gain on Knight Hawk transaction		(41,577)			(41,577)
Other operating (income) expense, net	(2,818)	(26,202)	1,781	22,847	(4,392)
	23,306	178,828	455,662		657,796
Income from investment in subsidiaries	126,555			(126,555)	
Income from operations	103,249	103,989	25,816	(126,555)	106,499
Interest expense, net:					
Interest expense	(33,524)	(780)	(18,387)	17,566	(35,125)
Interest income	2,272	75	15,842	(17,566)	623
	(31,252)	(705)	(2,545)		(34,502)
Income before income taxes	71,997	103,284	23,271	(126,555)	71,997
Provision for income taxes	5,723				5,723
Net income	66,274	103,284	23,271	(126,555)	66,274
Less: Net income attributable to noncontrolling interest	(118)				(118)
Net income attributable to Arch Coal	\$ 66,156	\$ 103,284	\$ 23,271	\$ (126,555)	\$ 66,156

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Condensed Consolidating Statements of Income

Six Months Ended June 30, 2011

(unaudited)

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Revenue					
Coal sales	\$	\$ 757,988	\$ 1,100,037	\$	