

ARCH COAL INC  
Form 10-Q  
November 08, 2012  
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 September 30, 2012

**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

**Arch Coal, Inc.**

(Exact name of registrant as specified in its charter)

Edgar Filing: ARCH COAL INC - Form 10-Q

**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 October 31, 2012 there were 212,277,465 shares of the registrant's common stock outstanding.

Table of Contents

**Table of Contents**

	<b>Page</b>
<u>Part I FINANCIAL INFORMATION</u>	3
<u>Item 1. Financial Statements</u>	3
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	38
<u>Item 4. Controls and Procedures</u>	39
<u>Part II OTHER INFORMATION</u>	40
<u>Item 1. Legal Proceedings</u>	40
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	44
<u>Item 4. Mine Safety Disclosures</u>	44
<u>Item 6. Exhibits</u>	45

Table of Contents**Part I****FINANCIAL INFORMATION****Item 1. Financial Statements.****Arch Coal, Inc. and Subsidiaries****Condensed Consolidated Statements of Operations****(in thousands, except per share data)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
			(Unaudited)	
<b>Revenues</b>	\$ 1,087,618	\$ 1,198,673	\$ 3,190,807	\$ 3,057,139
<b>Costs, expenses and other</b>				
Cost of sales	896,809	952,850	2,628,939	2,322,124
Depreciation, depletion and amortization	126,838	139,547	399,672	320,320
Amortization of acquired sales contracts, net	(4,093)	(12,698)	(22,561)	(5,492)
Change in fair value of coal derivatives and coal trading activities, net	5,840	8,360	(29,827)	9,248
Selling, general and administrative expenses	33,266	33,275	99,305	92,749
Legal contingencies	(79,532)		(79,532)	
Mine closure and asset impairment costs	(2,194)		523,568	7,316
Goodwill impairment			115,791	
Acquisition and transition costs - ICG		4,694		46,044
Other operating income, net	(25,276)	(3,611)	(45,605)	(9,018)
	951,658	1,122,417	3,589,750	2,783,291
Income (loss) from operations	135,960	76,256	(398,943)	273,848
Interest expense, net:				
Interest expense	(75,710)	(77,694)	(229,210)	(154,523)
Interest income	1,459	840	3,568	2,341
	(74,251)	(76,854)	(225,642)	(152,182)
Other nonoperating expense				
Bridge financing costs related to ICG				(49,490)
Net loss resulting from early retirement and refinancing of debt		(1,708)	(19,042)	(1,958)
		(1,708)	(19,042)	(51,448)
Income (loss) before income taxes	61,709	(2,306)	(643,627)	70,218
Provision for (benefit from) income taxes	15,958	(11,427)	(255,363)	(1,407)
Net income (loss)	45,751	9,121	(388,264)	71,625
Less: Net income attributable to noncontrolling interest		(231)	(268)	(822)
Net income (loss) attributable to Arch Coal, Inc.	\$ 45,751	\$ 8,890	\$ (388,532)	\$ 70,803
<b>Earnings per common share</b>				
Basic earnings (loss) per common share	\$ 0.22	\$ 0.04	\$ (1.83)	\$ 0.39
Diluted earnings (loss) per common share	\$ 0.22	\$ 0.04	\$ (1.83)	\$ 0.39

Edgar Filing: ARCH COAL INC - Form 10-Q

Weighted average shares outstanding							
Basic		212,053		211,337		211,931	182,898
Diluted		212,076		211,974		211,931	183,850
Dividends declared per common share	\$	0.03	\$	0.11	\$	0.17	\$ 0.32

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 Comprehensive Income (Loss)**

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
			(Unaudited)	
Net income (loss)	\$ 45,751	\$ 9,121	\$ (388,264)	\$ 71,625
Other comprehensive income (loss), net of income taxes:				
Pension, postretirement and other post-employment benefits	(615)	386	(3,795)	1,249
Unrealized gains (losses) on available-for-sale securities	(555)	(569)	(241)	(1,256)
Unrealized gains and losses on derivatives, net of reclassifications into net income:				
Unrealized gains (losses) on derivatives	65	(3,671)	2,816	2,703
Reclassifications of (gains) losses into net income	(347)	(3,575)	3,960	(10,059)
Total other comprehensive income (loss)	(1,452)	(7,429)	2,740	(7,363)
Total comprehensive income (loss)	\$ 44,299	\$ 1,692	\$ (385,524)	\$ 64,262

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

Table of Contents

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

	September 30, 2012	December 31, 2011
	(Unaudited)	
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 550,756	\$ 138,149
Restricted cash	3,450	10,322
Short term investments	99,359	
Trade accounts receivable	277,634	380,595
Other receivables	71,114	88,584
Inventories	391,526	377,490
Prepaid royalties	12,120	21,944
Deferred income taxes	65,395	42,051
Coal derivative assets	40,837	13,335
Other	67,495	110,304
Total current assets	1,579,686	1,182,774
<b>Property, plant and equipment, net</b>	<b>7,372,063</b>	<b>7,949,150</b>
<b>Other assets</b>		
Prepaid royalties	85,842	86,626
Goodwill	480,312	596,103
Equity investments	237,645	225,605
Other	180,306	173,701
Total other assets	984,105	1,082,035
Total assets	\$ 9,935,854	\$ 10,213,959
<b>Liabilities and Stockholders Equity</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 304,442	\$ 383,782
Coal derivative liabilities	3,498	7,828
Accrued expenses and other current liabilities	355,448	348,207
Current maturities of debt and short-term borrowings	115,695	280,851
Total current liabilities	779,083	1,020,668
Long-term debt	4,465,445	3,762,297
Asset retirement obligations	426,044	446,784
Accrued pension benefits	45,160	48,244
Accrued postretirement benefits other than pension	41,061	42,309
Accrued workers compensation	85,251	71,948
Deferred income taxes	746,079	976,753
Other noncurrent liabilities	182,464	255,382
Total liabilities	6,770,587	6,624,385
Redeemable noncontrolling interest		11,534
<b>Stockholders Equity</b>		
Common stock, \$0.01 par value, authorized 260,000 shares, issued 213,759 and 213,183 shares at September 30, 2012 and December 31, 2011, respectively	2,141	2,136
Paid-in capital	3,024,435	3,015,349
Treasury stock, at cost	(53,848)	(53,848)
Retained earnings	197,749	622,353
Accumulated other comprehensive loss	(5,210)	(7,950)
Total stockholders equity	3,165,267	3,578,040

Edgar Filing: ARCH COAL INC - Form 10-Q

Total liabilities and stockholders' equity	\$	9,935,854	\$	10,213,959
--	----	-----------	----	------------

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)

	Nine Months Ended September 30,	
	2012	2011
	(Unaudited)	
<b>Operating activities</b>		
Net income (loss)	\$ (388,264)	\$ 71,625
Adjustments to reconcile to cash provided by operating activities:		
Depreciation, depletion and amortization	399,672	320,320
Amortization of acquired sales contracts, net	(22,561)	(5,492)
Bridge financing costs related to ICG		49,490
Net loss resulting from early retirement of debt and refinancing activities	19,042	1,958
Noncash mine closure and asset impairment costs	501,942	7,316
Goodwill impairment	115,791	
Prepaid royalties expensed	19,802	26,880
Employee stock-based compensation expense	9,435	9,019
Amortization relating to financing activities	14,345	9,854
Changes in:		
Receivables	102,252	(35,874)
Inventories	(16,635)	(23,716)
Coal derivative assets and liabilities	(29,523)	15,199
Accounts payable, accrued expenses and other current liabilities	(51,968)	3,742
Income taxes, net	22,048	(21,971)
Deferred income taxes	(255,530)	17,062
Other	(83,453)	25,955
Cash provided by operating activities	356,395	471,367
<b>Investing activities</b>		
Acquisition of ICG, net of cash acquired		(2,894,339)
Change in restricted cash	6,872	(5,939)
Capital expenditures	(303,968)	(215,899)
Proceeds from dispositions of property, plant and equipment	22,624	25,133
Purchases of short term investments	(99,628)	
Investments in and advances to affiliates	(12,685)	(56,827)
Purchase of noncontrolling interest	(17,500)	
Additions to prepaid royalties	(9,192)	(26,135)
Cash used in investing activities	(413,477)	(3,174,006)
<b>Financing activities</b>		
Proceeds from the issuance of senior notes		2,000,000
Proceeds from term note	1,386,000	
Proceeds from the issuance of common stock, net		1,267,776
Payments to retire debt	(452,806)	(604,096)
Net increase (decrease) in borrowings under lines of credit and commercial paper program	(381,300)	283,096
Payments on term note	(3,500)	
Net payments on other debt	(13,078)	(8,792)
Debt financing costs	(34,686)	(114,587)
Dividends paid	(36,072)	(57,470)
Issuance of common stock under incentive plans	5,131	1,628
Cash provided by financing activities	469,689	2,767,555
Increase in cash and cash equivalents	412,607	64,916
Cash and cash equivalents, beginning of period	138,149	93,593

Edgar Filing: ARCH COAL INC - Form 10-Q

Cash and cash equivalents, end of period	\$	550,756	\$	158,509
--	----	---------	----	---------

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

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 thermal 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). The Company currently operates 15 mining complexes in West Virginia, Kentucky, Maryland, Virginia, Illinois, Wyoming, Colorado and Utah. All subsidiaries 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 nine month periods ended September 30, 2012 are not necessarily indicative of results to be expected for the year ending December 31, 2012. 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, 2011 included in the Company's Annual Report on Form 10-K/A filed with the U.S. Securities and Exchange Commission.

The Company's subsidiary Arch Western Resources, LLC (Arch Western) operates coal mines in Wyoming, Colorado and Utah. On April 9, 2012, Delta Housing, Inc., a subsidiary of BP p.l.c. and a joint venture partner in Arch Western, exercised their contractual right to require the Company to purchase their 0.5% common and their preferred membership interests in Arch Western. The negotiated purchase amount of \$17.5 million was paid on July 2, 2012.

**2. Accounting Policies**

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

**3. Debt**

September 30,  
2012

December 31,  
2011

Edgar Filing: ARCH COAL INC - Form 10-Q

	(In thousands)			
Indebtedness to banks under credit facilities	\$	100,000	\$	481,300
Term loan (\$1.4 billion face value) due 2018		1,383,375		
6.75% senior notes (\$450.0 million face value) due 2013				450,971
8.75% senior notes (\$600.0 million face value) due 2016		590,475		588,974
7.00% senior notes due 2019 at par		1,000,000		1,000,000
7.25% senior notes due 2020 at par		500,000		500,000
7.25% senior notes due 2021 at par		1,000,000		1,000,000
Other		7,290		21,903
		4,581,140		4,043,148
Less current maturities of debt and short-term borrowings		115,695		280,851
Long-term debt	\$	4,465,445	\$	3,762,297

The current maturities of debt include contractual maturities and amounts borrowed under our revolving credit facility and accounts receivable securitization program that the Company does not intend to refinance on a long-term basis, based on cash projections and management's plans.

On May 16, 2012, the Company entered into an amendment to its senior secured revolving credit facility that amended certain financial maintenance covenants, suspending the Company's compliance with the debt-to-EBITDA ratio, easing other financial covenants through September 2014 and adding defined minimum EBITDA targets. The maximum borrowing capacity of the revolving credit facility was reduced from \$2 billion to \$600 million. In conjunction with the amendment, the Company borrowed \$1.4 billion under a six-year secured term loan facility, issued at a 1% discount. The term loan contains no financial maintenance covenants, is prepayable and is secured by the same assets as borrowings under the revolving credit

Table of Contents

facility. Quarterly principal payments of \$3.5 million are due beginning in September 2012, plus interest at a rate of the greater of a LIBOR-based rate or 1.25%, plus 450 basis points. The proceeds of the term loan were used to retire all outstanding borrowings under the revolving credit facility and the outstanding \$450.0 million principal amount of 6.75% Senior Notes due 2013 issued by Arch Western Finance, LLC ( Arch Western Finance ), the Company s indirect subsidiary.

On May 16, 2012, Arch Western Finance accepted for purchase an aggregate of approximately \$304.0 million principal amount of its 6.75% Senior Notes due 2013 in an initial settlement pursuant to the terms of its tender offer and consent solicitation, which commenced on May 1, 2012, and called for redemption all of the remaining notes outstanding after the completion of the tender offer. The consideration for each \$1,000 of principal purchased under the tender offer and consent solicitation was \$1,002.50, for a total purchase consideration of \$304.8 million. On May 30, 2012, the remaining notes with an outstanding principal amount of \$146.0 million were redeemed at par value.

The Company incurred financing costs of \$27.4 million in conjunction with the term loan, which have been deferred on the balance sheet. The Company wrote off \$17.3 million of the \$24.8 million of previously deferred financing costs relating to the reduction in capacity of the senior secured revolving credit facility and \$1.1 million related to the redemption of the 6.75% Senior Notes due 2013, offset by the \$0.8 million of unamortized issue premium on the notes. The write-off of deferred financing fees, along with other transaction fees associated with these transactions, is reflected in Loss on extinguishment and refinancing of debt in the condensed consolidated statements of operations.

Since May, when borrowings under the revolving credit facility were retired with the proceeds of the term loan, we have borrowed only under the accounts receivable securitization program. At September 30, 2012, the available borrowing capacity under our lines of credit was approximately \$366 million.

**4. Mine Closure and Asset Impairment Costs**

In response to decreasing demand for thermal coal, the Company made the decision in the second quarter of 2012 to close four mining complexes and to temporarily idle a fifth complex, all acquired with ICG. The company also curtailed production at other Appalachia mines. These actions resulted in a total workforce reduction of approximately 750 positions. The operations had ceased production prior to June 30, 2012, but continued to ship from inventory in the third quarter of 2012. The Company will incur customary annual maintenance costs related to these properties in the future. The terms of customer contracts will be fulfilled by other operations.

The following costs are reflected in the line Mine closure and asset impairment costs on the condensed consolidated statements of operations for the nine months ended September 30, 2012:

Parts and supplies inventory writedown	\$	2,598
Impairment of property, plant and equipment		95,641
Impairment of coal properties and deferred development costs		403,279
Royalty obligations		11,546
Employee termination benefits		12,274
Pension, postretirement and occupational disease curtailment gain, net (see notes 13 and 14)		(1,770)
	\$	523,568

The fair value of the closed or idled operations property, plant and equipment of approximately \$51 million was based on the analysis of the marketability of thermal coal properties in the current market environment and our ability to redeploy equipment to other facilities.

The majority of the employee termination benefits were paid in the third quarter of 2012. The royalty obligations represent minimum payments on various leases and will be paid over the remaining term of the leases, through 2016.

The announcement of the closures triggered an actuarial curtailment under the Company's sponsored pension, post-retirement medical and black lung benefit programs. Certain employees were informed that they would be terminated effective August 21, 2012, which triggered the recognition of the remaining pension plan curtailment impact in the third quarter of 2012, a curtailment gain of \$2.2 million.

#### **5. Investments in Available-for-Sale Securities**

From the proceeds of the term loan discussed in Note 3, Debt, the Company invested in marketable debt securities, primarily highly liquid AA-rated corporate bonds, U.S. government and government agency securities. These investments are

Table of Contents

held in the custody of a major financial institution. These securities, along with the Company's investments in marketable equity securities, are classified as available-for-sale securities and, accordingly, the unrealized gains and losses are recorded through other comprehensive income.

The Company's investments in available-for-sale marketable securities are as follows:

**September 30, 2012**

	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value	Balance Sheet Classification	
					Short-Term Investments	Other Assets
(In thousands)						
Available-for-sale:						
U.S. government and agency securities	\$ 72,964	\$	\$ (157)	\$ 72,807	\$ 72,807	\$
Corporate notes and bonds	26,664		(112)	26,552	26,552	
Equity securities	5,271	4,678	(2,514)	7,435		7,435
Total Investments	\$ 104,899	\$ 4,678	\$ (2,783)	\$ 106,794	\$ 99,359	\$ 7,435

**December 31, 2011**

	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Balance Sheet Classification	
					Short-Term Investments	Other Assets
(In thousands)						
Available-for-sale:						
Equity securities	\$ 5,268	\$ 4,394	\$ (2,122)	\$ 7,540	\$	\$ 7,540
Total Investments	\$ 5,268	\$ 4,394	\$ (2,122)	\$ 7,540	\$	\$ 7,540

Most of the debt securities have maturity dates in 2013, and the remainder mature in the first quarter of 2014. The Company classifies its investments as current based on the nature of the investments and their availability for use in current operations.

**6. Goodwill**

During the second quarter of 2012, a significant drop in the Company's stock price, combined with continuing weak demand for thermal coal during the quarter and the Company's resulting production cuts, indicated that the fair value of the Company's goodwill could be less than its carrying value. Accordingly, the Company performed the first step of the two-step goodwill impairment test as of June 30, 2012. The fair values of the reporting units were determined using a discounted cash flow (DCF) technique. A number of significant assumptions and estimates were involved in the application of the DCF analysis to forecast operating cash flows, including the discount rate and projections of sales volumes, selling prices and costs to produce.

## Edgar Filing: ARCH COAL INC - Form 10-Q

The value of the Company's Black Thunder reporting unit in the Powder River Basin, where \$115.8 million of goodwill had been allocated, is sensitive to market demand for thermal coal. The further weakening in thermal coal markets significantly impacted the projected demand for and pricing of coal produced at Black Thunder. In step one of the goodwill impairment testing, the fair value of the Black Thunder reporting unit did not exceed its carrying value, primarily due to the impact of lower demand on near term sales volumes and pricing. The second step of the test requires that we determine the fair value of Black Thunder's goodwill, which involves determining the value of Black Thunder's assets and liabilities. The Company is in the process of completing this valuation. Based on initial estimates of the fair values of the assets and liabilities and the deficit of the fair value when compared to the related book values, the Company recorded a preliminary impairment charge for the entire \$115.8 million carrying value of Black Thunder's goodwill during the second quarter of 2012.

The goodwill amounts allocated to certain reporting units in the Company's Appalachia segment are sensitive to volatility in the demand for metallurgical coal. Should metallurgical coal markets weaken from the estimates used in the first step of the



Table of Contents

impairment test, affecting the estimates of volumes and pricing of metallurgical coal from the Company's operations, it could cause the fair value of the reporting units to be less than their carrying value, requiring us to perform step 2 of the test for impairment.

**7. Equity Investments and Membership Interests in Joint Ventures**

The Company accounts for its investments and membership interests in joint ventures under the equity method of accounting if the Company has the ability to exercise significant influence, but not control, over the entity. Below are the equity method investments reflected in the condensed consolidated balance sheets:

In thousands	Knight Hawk Holdings, LLC	DKRW Advanced Fuels, LLC	Dominion Terminal Associates	Tenaska Trailblazer Partners, LLC	Millennium Bulk Terminals, LLC	Tongue River Holding Company, LLC	Total
Balance at December 31, 2011	\$ 135,225	\$ 19,715	\$ 16,086	\$ 15,266	\$ 26,324	\$ 12,989	\$ 225,605
Investments in affiliates							
Advances to (distributions from) affiliates, net	(5,342)		3,230		5,853	1,708	5,449
Equity in comprehensive income (loss)	16,033	(3,457)	(3,625)	(2)	(2,358)		6,591
Balance at September 30, 2012	\$ 145,916	\$ 16,258	\$ 15,691	\$ 15,264	\$ 29,819	\$ 14,697	\$ 237,645
Notes receivable from investees:							
Balance at December 31, 2011	\$	\$ 30,751	\$	\$ 5,059	\$	\$	\$ 35,810
Balance at September 30, 2012	\$	\$ 36,402	\$	\$ 5,076	\$	\$	\$ 41,478

The Company may be required to make future contingent payments of up to \$72.9 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***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 anticipates purchasing approximately 73 to 78 million gallons of diesel fuel for use in its operations during 2012. To protect the Company's cash flows from increases in the price of diesel fuel for its operations, the Company uses forward physical diesel purchase contracts and purchased heating oil call options, and in the past, heating oil swaps. At September 30, 2012, the Company had protected the price of approximately 80% of its expected purchases

## Edgar Filing: ARCH COAL INC - Form 10-Q

for the remainder of 2012 and 67% of its 2013 purchases. At September 30, 2012, the Company had purchased heating oil call options for approximately 63.5 million gallons for the purpose of managing the price risk associated with future diesel purchases.

During the first quarter of 2012, the Company determined the effectiveness of the heating oil options could not be established as of December 31, 2011 and on an ongoing basis. As a result, the amount remaining in accumulated other comprehensive income of \$8.2 million, or \$5.2 million net of income taxes, was recorded in earnings, in the other operating income, net line on the condensed consolidated statement of operations.

The Company also purchased heating oil call options to hedge the fuel surcharges on its barge and rail shipments that cover increases in diesel fuel prices. These positions reduce the Company's risk of cash flow fluctuations related to these surcharges but the positions are not accounted for as hedges. At September 30, 2012, the Company held purchased call options for approximately 14 million gallons for the purpose of managing the fluctuations in cash flows associated with fuel surcharges on future shipments.

### *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

Edgar Filing: ARCH COAL INC - Form 10-Q

Table of Contents

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 September 30, 2012, the Company held derivatives for risk management purposes that are expected to settle in the following years:

(Tons in thousands)	2012	2013	2014	2015	Total
Coal sales	2,915	5,713	4,020	720	13,368
Coal purchases	1,851	1,140	900		3,891

*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 estimated future realization of the value of the trading portfolio is \$3.6 million of gains in the remainder of 2012 and \$1.6 million of losses 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 consolidated balance sheets. The amounts shown in the table below represent the fair value position of individual contracts, and not 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)	September 30, 2012		December 31, 2011	
	Asset Derivative	Liability Derivative	Asset Derivative	Liability Derivative
<b>Derivatives Designated as Hedging Instruments</b>				
Heating oil diesel purchases	\$	\$	\$ 8,997	\$
Coal	4,509	(1,679)	1,109	
Total	4,509	(1,679)	10,106	
<b>Derivatives Not Designated as Hedging Instruments</b>				
Heating oil diesel purchases	10,913	(57)		
Heating oil fuel surcharges	2,839		1,797	
Coal held for trading purposes	27,190	(25,171)	15,505	(19,927)
Coal risk management	45,739	(13,249)	14,855	(6,035)
Total	86,681	(38,477)	32,157	(25,962)
Total derivatives	91,190	(40,156)	42,263	(25,962)
Effect of counterparty netting	(36,658)	36,658	(18,134)	18,134

Edgar Filing: ARCH COAL INC - Form 10-Q

<b>Net derivatives as classified in the balance sheets</b>	\$	54,532	\$	(3,498)	\$	51,034	\$	24,129	\$	(7,828)	\$	16,301
--	----	--------	----	---------	----	--------	----	--------	----	---------	----	--------

		September 30, 2012	December 31, 2011
<b>Net derivatives as reflected on the balance sheets</b>			
<b>Heating oil</b>	Other current assets	\$ 13,695	\$ 10,794
<b>Coal</b>	Coal derivative assets	40,837	13,335
	Coal derivative liabilities	(3,498)	(7,828)
		\$ 51,034	\$ 16,301

Table of Contents

The Company had a current liability for the obligation to post cash collateral of \$7.4 million at September 30, 2012 and a current asset for the right to reclaim cash collateral of \$12.4 million at December 31, 2011. These amounts are not included with the derivatives presented in the table above and are included in accrued expenses and other current liabilities and other current assets, respectively, in the accompanying condensed consolidated balance sheets.

The effects of derivatives on measures of financial performance are as follows for the three month periods ended September 30:

**Derivatives used in Cash Flow Hedging Relationships (in thousands)**

**For the three months ended September 30**

	Gain (Loss) Recognized in Other Comprehensive Income(Effective Portion)		Gains (Losses) Reclassified from Other Comprehensive Income into Income (Effective Portion)	
	2012	2011	2012	2011
	\$	\$	\$	\$
Heating oil diesel purchases	\$	\$ (6,386)	\$	\$ 5,122(2)
Coal sales	259	1,820	542	466(1)
Coal purchases	(178)	(1,274)		(2)
Totals	\$ 81	\$ (5,840)	\$ 542	\$ 5,588

No ineffectiveness or amounts excluded from effectiveness testing relating to the Company's cash flow hedging relationships were recognized in the results of operations in the three month periods ended September 30, 2012 and 2011.

**Derivatives Not Designated as Hedging Instruments (in thousands)**

**For the three months ended September 30**

	Gain (Loss) Recognized	
	2012	2011
	\$	\$
Coal unrealized	\$ (11,328)	\$ (6,131)(3)
Coal realized	\$ 14,072	\$ 166(4)
Heating oil diesel purchases	\$ 5,184	\$ (4)
Heating oil fuel surcharges	\$ 1,092	\$ (2,501)(4)

**Location in statement of operations:**

- (1) Revenues
- (2) Cost of sales

Edgar Filing: ARCH COAL INC - Form 10-Q

- (3) Change in fair value of coal derivatives and coal trading activities, net
- (4) Other operating income, net

The effects of derivatives on measures of financial performance are as follows for the nine month periods ended September 30:

**Derivatives used in Cash Flow Hedging Relationships (in thousands)**

**For the nine months ended September 30**

	Gain (Loss) Recognized in Other Comprehensive Income (Effective Portion)		Gains (Losses) Reclassified from Other Comprehensive Income into Income (Effective Portion)	
	2012	2011	2012	2011
Heating oil diesel purchases	\$	\$	1,535	\$ 14,946(2)
Coal sales	4,983	4,570	1,552	790(1)
Coal purchases	(1,122)	(2,053)		(2)
Totals	\$ 3,861	\$ 4,052	\$ 1,552	\$ 15,736

Table of Contents

No ineffectiveness or amounts excluded from effectiveness testing relating to the Company's cash flow hedging relationships were recognized in the results of operations in the nine month periods ended September 30, 2012 and 2011.

**Derivatives Not Designated as Hedging Instruments (in thousands)****For the nine months ended September 30**

	Gain (Loss) Recognized	
	2012	2011
Coal unrealized	\$ 23,670	\$ (7,550)(3)
Coal realized	\$ 25,901	\$ 313(4)
Heating oil diesel purchases	\$ (16,902)	\$ (4)
Heating oil fuel surcharges	\$ (1,140)	\$ (2,501)(4)

**Location in statement of operations:**

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

Related to the Company's trading portfolio, net unrealized and realized gains of \$5.5 million and losses of \$2.2 million were recognized during the three months ended September 30, 2012 and 2011, respectively. The Company recognized net unrealized and realized gains of \$6.2 million and losses of \$1.7 million during the nine months ended September 30, 2012 and 2011, respectively, related to its trading portfolio, which are included in the caption "Change in fair value of coal derivatives and coal trading activities, net" in the accompanying condensed consolidated statements of operations, and are not included in the previous tables reflecting the effects of derivatives on measures of financial performance.

Based on fair values at September 30, 2012, gains on derivative contracts designated as hedge instruments in cash flow hedges of approximately \$4.0 million are expected to be reclassified from other comprehensive income into earnings during the next twelve months.

**9. Inventories**

Inventories consist of the following:

## Edgar Filing: ARCH COAL INC - Form 10-Q

	September 30, 2012	December 31, 2011
	(In thousands)	
Coal	\$ 202,103	\$ 206,517
Repair parts and supplies	178,710	163,527
Work-in-process	10,713	7,446
	\$ 391,526	\$ 377,490

The repair parts and supplies are stated net of an allowance for slow-moving and obsolete inventories of \$11.4 million at September 30, 2012, and \$13.1 million at December 31, 2011.

### 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, U.S Treasury securities, and coal futures that are submitted for clearing on the New York Mercantile Exchange.



Table of Contents

- 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 U.S. government agency securities and 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 (coal and heating oil) valued using modeling techniques, such as Black-Scholes, that require the use of inputs, particularly volatility, that are rarely observable. Changes in the unobservable inputs would not have a significant impact on the reported Level 3 fair values at September 30, 2012.

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 September 30, 2012		
		Level 1	Level 2	Level 3
(In thousands)				
<b>Assets</b>				
Investments in marketable securities	\$ 106,794	\$ 58,109	\$ 48,685	\$
Derivatives	54,532	40,884	(47)	13,695
Total assets	\$ 161,326	\$ 98,993	\$ 48,638	\$ 13,695
<b>Liabilities:</b>				
Derivatives	\$ 3,498	\$	\$ 1,912	\$ 1,586

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 September 30, 2012		Nine Months Ended September 30, 2012	
Balance, beginning of period	\$	5,109	\$	6,211
Realized and unrealized losses recognized in earnings, net		4,265		(7,331)
Realized and unrealized losses recognized in other comprehensive income, net				
Purchases		2,869		14,598
Issuances				
Settlements		(134)		(1,369)
Ending balance	\$	12,109	\$	12,109

## Edgar Filing: ARCH COAL INC - Form 10-Q

Net unrealized gains during the three month period ended September 30, 2012 related to level 3 financial instruments held on September 30, 2012 was \$4.3 million. Net unrealized losses during the nine month period ended September 30, 2012 related to level 3 financial instruments held on September 30, 2012 was \$3.1 million.

### *Fair Value of Long-Term Debt*

At both September 30, 2012 and December 31, 2011, the fair value of the Company's debt, including amounts classified as current, was \$4.2 billion. Fair values are based upon observed prices in an active market when available or from valuation models using market information.

### **11. Accrued Expenses and Other Current Liabilities**

Accrued expenses and other current liabilities consist of the following:

Table of Contents

	September 30, 2012	December 31, 2011
	(In thousands)	
Payroll and employee benefits	\$ 80,782	\$ 65,323
Taxes other than income taxes	123,100	133,331
Interest	70,619	55,266
Acquired sales contracts	16,327	38,441
Workers compensation	10,155	11,666
Asset retirement obligations	44,178	27,119
Other	10,287	17,061
	\$ 355,448	\$ 348,207

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

During the nine months ended September 30, 2012 the Company granted options to purchase approximately 1.3 million shares of common stock with a weighted average exercise price of \$13.30 per share and a weighted average grant-date fair value of \$5.27 per share. The options' fair value was determined using the Black-Scholes option pricing model, using a weighted average risk-free rate of 0.757%, a weighted average dividend yield of 2.92% and a weighted average volatility of 60.72%. The options' expected life is 4.5 years and the options vest ratably over three years and 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.

During the nine months ended September 30, 2012, the Company also granted restricted share awards totaling 569,550 shares whose average market price at the time of grant was \$13.32. The shares vest over three years.

The Company has a long-term incentive program that allows for the award of performance units. 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 accrued and unpaid for all grants under the plan totaled \$11.8 million and \$9.6 million as of September 30, 2012 and December 31, 2011, respectively.

**13. Workers Compensation Expense**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Service cost	\$ 419	\$ 807	\$ 1,458	\$ 1,246
Interest cost	629	619	1,708	1,177
Net amortization		(109)	(574)	(370)
Curtailments			1,933	

Edgar Filing: ARCH COAL INC - Form 10-Q

Total occupational disease	1,048	1,317	4,525	2,053
Traumatic injury claims and assessments	7,453	5,207	19,052	10,856
Total workers compensation expense	\$ 8,501	\$ 6,524	\$ 23,577	\$ 12,909

Table of Contents**14. Employee Benefit Plans**

The following table details the components of pension benefit costs:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Service cost	\$ 6,156	\$ 4,122	\$ 21,062	\$ 12,367
Interest cost	3,683	4,063	11,755	12,190
Curtailments			324	
Expected return on plan assets	(5,508)	(5,453)	(16,523)	(16,359)
Amortization of prior service cost (credit)	273	(47)	200	(142)
Amortization of other actuarial losses	3,248	2,187	11,019	6,561
Net benefit cost	\$ 7,852	\$ 4,872	\$ 27,837	\$ 14,617

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Service cost	\$ 541	\$ 1,493	\$ 1,629	\$ 2,416
Interest cost	508	1,125	1,519	2,152
Curtailments	(2,212)		(4,049)	
Amortization of prior service cost credits	(2,837)	(636)	(8,708)	(1,773)
Amortization of other actuarial gains	(130)	(775)	(391)	(2,325)
Net benefit cost (credit)	\$ (4,130)	\$ 1,207	\$ (10,000)	\$ 470

**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 September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Weighted average shares outstanding:				
Basic weighted average shares outstanding	212,053	211,337	211,931	182,898
Effect of common stock equivalents under incentive plans	23	637		952
Diluted weighted average shares outstanding	212,076	211,974	211,931	183,850

## Edgar Filing: ARCH COAL INC - Form 10-Q

The weighted effect of restricted stock, restricted stock units and options for 5.8 million and 3.0 million shares of common stock for the three months ended September 30, 2012 and 2011, respectively, and 5.0 million and 2.1 million shares for the nine months ended September 30, 2012 and 2011, respectively, were excluded from the calculation of diluted weighted average shares outstanding because the effect would have been antidilutive.

### 16. Guarantees

On December 31, 2005, Arch entered into a purchase and sale agreement with Magnum Coal Company ( Magnum ) to sell certain assets to Magnum. On July 23, 2008, Patriot Coal Corporation acquired Magnum. On July 9, 2012, Patriot Coal Corporation and certain of its wholly owned subsidiaries, including Magnum, (collectively, Patriot ) filed voluntary petitions for reorganization under Chapter 11 of the U.S. Code in the U.S. Bankruptcy Court for the Southern District of New York ( Bankruptcy Court ).

The Company has agreed to continue to provide surety bonds and letters of credit for certain Magnum obligations, primarily reclamation. The surety bonding amounts are mandated by the state and are not directly related to the estimated cost to reclaim the properties. At September 30, 2012, the Company had \$35.3 million of surety bonds remaining related to Magnum properties , however Patriot Coal has posted letters of credit of \$16.7 million in the Company s favor.

Table of Contents

On September 20, 2012, Patriot filed a motion in the Bankruptcy Court to reject a master coal sales and services agreement entered into on December 31, 2005 between Arch and Magnum that was established to supply coal for a sales agreement with a customer who did not consent to the assignment of their contract to Magnum. The motion is pending before the court. The underlying coal sales agreement provides the coal supplier with the ability to either ship coal or to elect to buy out of its monthly obligations at amounts that are predetermined for the remainder of the agreement. The remaining monthly buyout election payments total approximately \$64 million, payable if elected through the end of the contract in 2017. If the Bankruptcy Court approves the rejection of the master coal sales agreement, the Company believes it would have the right to source the underlying contract from a variety of alternative sources, including the potential of sourcing it from its operations. The Company could elect to buy out of the contract obligations, depending on market conditions. The Company does not expect that, if elected, the monthly buyout payments would have a material impact on the Company's liquidity.

Additionally, a predecessor of the Company entered into a guarantee for the delivery of coal under a contract assigned to Magnum. Patriot's motion to reject the contract has been approved by the Bankruptcy Court. If the guarantee is enforceable against the Company, then it may be required to fulfill Magnum's delivery or payment obligations. The Company does not expect that fulfilling the guarantee would have a material impact on the Company's liquidity.

Because the Company does not believe that it is probable that it would have to purchase replacement coal to fulfill the customer contract or perform under the guarantee, no losses have been recorded in the consolidated financial statements as of September 30, 2012.

Should Patriot not emerge from bankruptcy, or is incapable of paying retiree medical benefits pursuant to Section 9711 of the Coal Industry Retiree Health Benefit Act of 1992 ( Coal Act ) to a certain subset of retirees, the Company could become responsible for their retiree medical obligations. The retirees were employees of certain subsidiaries sold to Magnum and their predecessor entities who retired prior to October 1, 1994. The Company does not have the information necessary to determine the potential amount of such obligations, but does not expect that the annual benefit payments would have a material impact on the Company's liquidity.

## **17. Contingencies**

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 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

## Edgar Filing: ARCH COAL INC - Form 10-Q

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. ICG's counterclaim was dismissed on motion for summary judgment entered on May 11, 2010. Allegheny's claims 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 damage calculations were significantly inflated because they were not determined 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. ICG and Allegheny filed post-verdict motions in the trial court and on August 23, 2011, the court denied the parties' motions. The court entered a final judgment on August 25, 2011, in the amount of \$104.1 million, which included pre-judgment interest. The parties appealed the lower court's decision to the



Table of Contents

Superior Court of Pennsylvania. Wolf Run and Hunter Ridge have filed an appeal bond in the amount of \$124.9 million. On August 13, 2012, the Superior Court of Pennsylvania ruled that the lower court should have calculated damages as of the date of breach, and remanded the matter back to the lower court with instructions to recalculate the award. This ruling resulted in a reduction of the Company's best estimate of the probable loss related to this lawsuit.

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. As of September 30, 2012 and December 31, 2011, the Company had accrued \$32.3 million and \$117.2 million, respectively, for all legal matters, including \$4.3 million and \$6.3 million classified as current. The ultimate resolution of any such legal matter could result in outcomes which may be materially different from amounts the Company has accrued for such matters.

**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 nine month periods ended September 30, 2012 and 2011 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.

The asset amounts below represent an allocation of assets consistent with the Company's incentive compensation plans. 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. Goodwill is allocated to the respective reporting units, even though it may not be reflected in the subsidiaries' financial statements.

Edgar Filing: ARCH COAL INC - Form 10-Q

Table of Contents

	PRB	APP	WBIT	Other Operating Segments	Corporate, Other and Eliminations	Consolidated
	(in thousands)					
<b>Three Months Ended</b>						
<b>September 30, 2012</b>						
Revenues	\$ 406,719	\$ 436,409	\$ 217,963	\$ 26,527	\$	\$ 1,087,618
Income (loss) from operations	38,873	88,695	40,828	(1,298)	(31,138)	135,960
Depreciation, depletion and amortization	43,944	61,596	17,881	2,594	823	126,838
Amortization of acquired sales contracts, net	(589)	(3,711)		207		(4,093)
Mine closure and asset impairment costs		(1,801)	(50)	(210)	(133)	(2,194)
Capital expenditures	5,620	77,772	13,510	3,640	1,353	101,895
<b>Three Months Ended</b>						
<b>September 30, 2011</b>						
Revenues	\$ 394,012	\$ 611,403	\$ 168,795	\$ 24,463	\$	\$ 1,198,673
Income (loss) from operations	38,632	63,350	24,653	(1,487)	(48,892)	76,256
Depreciation, depletion and amortization	42,676	73,420	19,125	3,674	652	139,547
Amortization of acquired sales contracts, net	3,802	(15,701)		(832)	33	(12,698)
Mine closure and asset impairment costs						
Capital expenditures	20,937	62,121	16,110	4,705	4,300	108,173
<b>Nine Months Ended</b>						
<b>September 30, 2012</b>						
Revenues	\$ 1,130,408	\$ 1,409,776	\$ 562,074	\$ 88,549	\$	\$ 3,190,807
Income (loss) from operations	94,163	(388,563)	85,848	(3,757)	(186,634)	(398,943)
Depreciation, depletion and amortization	122,298	210,789	54,935	9,704	1,946	399,672
Amortization of acquired sales contracts, net	(1,374)	(21,658)		471		(22,561)
Mine closure and asset impairment costs		524,115	129	(437)	(239)	523,568
Total assets	2,234,941	3,846,136	676,057	454,118	2,724,602	9,935,854
Capital expenditures	15,399	222,177	42,761	8,153	15,478	303,968
<b>Nine Months Ended</b>						
<b>September 30, 2011</b>						
Revenues	\$ 1,178,537	\$ 1,336,581	\$ 513,388	\$ 28,633	\$	\$ 3,057,139
Income (loss) from operations	121,118	205,701	95,217	(1,412)	(146,776)	273,848
Depreciation, depletion and amortization	125,532	127,526	61,753	4,210	1,299	320,320
Amortization of acquired sales contracts, net	15,349	(19,907)		(934)		(5,492)
Mine closure and asset impairment costs		7,316				7,316
Total assets	2,240,458	5,241,004	667,658	452,491	1,360,046	9,961,657
Capital expenditures	39,422	108,711	38,003	9,078	20,685	215,899

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



Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Income (loss) from operations	\$ 135,960	\$ 76,256	\$ (398,943)	\$ 273,848
Interest expense	(75,710)	(77,694)	(229,210)	(154,523)
Interest income	1,459	840	3,568	2,341
Other nonoperating expense		(1,708)	(19,042)	(51,448)
Income (loss) before income taxes	\$ 61,709	\$ (2,306)	\$ (643,627)	\$ 70,218

**19. Supplemental Condensed Consolidating Financial Information**

Pursuant to the indentures governing Arch Coal, Inc.'s 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 condensed consolidating financial information for (i) the Company, (ii) the issuer of the senior notes, (iii) the guarantors under the senior notes, and (iv) the entities which are not guarantors under the senior notes (Arch Receivable Company, LLC and the Company's subsidiaries outside the U.S.):

Table of Contents**Condensed Consolidating Statements of Operations****Three Months Ended September 30, 2012**

	Parent/Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
<b>Revenues</b>	\$	\$ 1,087,618	\$	\$	\$ 1,087,618
<b>Costs, expenses and other</b>					
Cost of sales	2,434	922,455		(28,080)	896,809
Depreciation, depletion and amortization	1,400	125,429	9		126,838
Amortization of acquired sales contracts, net		(4,093)			(4,093)
Legal contingencies		(79,532)			(79,532)
Mine closure and asset impairment costs		(2,194)			(2,194)
Goodwill impairment					
Selling, general and administrative expenses	22,050	11,353	1,783	(1,920)	33,266
Change in fair value of coal derivatives and coal trading activities, net		5,840			5,840
Other operating (income) expense, net	(11,051)	(44,137)	(89)	30,001	(25,276)
	14,833	935,121	1,703	1	951,658
Income from investment in subsidiaries	159,653			(159,653)	
Income (loss) from operations	144,820	152,497	(1,703)	(159,654)	135,960
Interest expense, net:					
Interest expense	(91,589)	(7,021)	(649)	23,549	(75,710)
Interest income	8,478	14,584	1,946	(23,549)	1,459
	(83,111)	7,563	1,297		(74,251)
Other non-operating expense					
Bridge financing costs related to ICG					
Net loss resulting from early retirement of ICG debt					
Income (loss) before income taxes	61,709	160,060	(406)	(159,654)	61,709
Provision for income taxes	15,958				15,958
Net income (loss)	45,751	160,060	(406)	(159,654)	45,751
Less: Net income attributable to noncontrolling interest					
Net income (loss) attributable to Arch Coal, Inc.	\$ 45,751	\$ 160,060	\$ (406)	\$ (159,654)	\$ 45,751
Total comprehensive income (loss)	\$ 45,494	\$ 158,864	\$ (406)	\$ (159,653)	\$ 44,299

Table of Contents**Condensed Consolidating Statements of Operations****Nine Months Ended September 30, 2012**

	Parent/Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
<b>Revenues</b>	\$	\$ 3,190,807	\$	\$	\$ 3,190,807
<b>Costs, expenses and other</b>					
Cost of sales	7,691	2,696,114		(74,866)	2,628,939
Depreciation, depletion and amortization	3,960	395,688	24		399,672
Amortization of acquired sales contracts, net		(22,561)			(22,561)
Legal contingencies		(79,532)			(79,532)
Mine closure and asset impairment costs		523,568			523,568
Goodwill impairment		115,791			115,791
Selling, general and administrative expenses	62,468	36,388	5,871	(5,422)	99,305
Change in fair value of coal derivatives and coal trading activities, net		(29,827)			(29,827)
Other operating (income) expense, net	(7,692)	(105,753)	(12,449)	80,289	(45,605)
	66,427	3,529,876	(6,554)	1	3,589,750
Income from investment in subsidiaries	(316,041)			316,041	
Income (loss) from operations	(382,468)	(339,069)	6,554	316,040	(398,943)
Interest expense, net:					
Interest expense	(263,428)	(27,815)	(2,382)	64,415	(229,210)
Interest income	19,615	42,557	5,811	(64,415)	3,568
	(243,813)	14,742	3,429		(225,642)
Other non-operating expense					
Bridge financing costs related to ICG					
Net loss resulting from early retirement of debt	(17,349)	(1,693)			(19,042)
	(17,349)	(1,693)			(19,042)
Income (loss) before income taxes	(643,630)	(326,020)	9,983	316,040	(643,627)
Benefit from income taxes	(256,944)		1,581		(255,363)
Net income (loss)	(386,686)	(326,020)	8,402	316,040	(388,264)
Less: Net income attributable to noncontrolling interest	(268)				(268)
Net income (loss) attributable to Arch Coal, Inc.	\$ (386,954)	\$ (326,020)	\$ 8,402	\$ 316,040	\$ (388,532)
Total comprehensive income (loss)	\$ (385,185)	\$ (324,785)	\$ 8,402	\$ 316,044	\$ (385,524)

Table of Contents**Condensed Consolidating Statements of Operations****Three Months Ended September 30, 2011**

	Parent/Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
<b>Revenues</b>	\$	\$ 1,198,673	\$	\$	\$ 1,198,673
<b>Costs, expenses and other</b>					
Cost of sales	7,439	971,319		(25,908)	952,850
Depreciation, depletion and amortization	720	138,827			139,547
Amortization of acquired sales contracts, net		(12,698)			(12,698)
Mine closure and asset impairment costs					
Goodwill impairment					
Selling, general and administrative expenses	20,261	13,752	1,058	(1,796)	33,275
Change in fair value of coal derivatives and coal trading activities, net		8,360			8,360
Acquisition and transition costs related to ICG	4,694				4,694
Other operating (income) expense, net	(6,062)	(25,314)	61	27,704	(3,611)
	27,052	1,094,246	1,119		1,122,417
Income from investment in subsidiaries	105,198			(105,198)	
Income (loss) from operations	78,146	104,427	(1,119)	(105,198)	76,256
Interest expense, net:					
Interest expense	(84,044)	(11,060)	(541)	17,951	(77,694)
Interest income	3,592	14,023	1,176	(17,951)	840
	(80,452)	2,963	635		(76,854)
Other non-operating expense					
Bridge financing costs related to ICG					
Net loss resulting from early retirement of debt		(1,708)			(1,708)
		(1,708)			(1,708)
Income (loss) before income taxes	(2,306)	105,682	(484)	(105,198)	(2,306)
Benefit from income taxes	(11,427)				(11,427)
Net income (loss)	9,121	105,682	(484)	(105,198)	9,121
Less: Net income attributable to noncontrolling interest	(231)				(231)
Net income (loss) attributable to Arch Coal, Inc.	\$ 8,890	\$ 105,682	\$ (484)	\$ (105,198)	\$ 8,890
Total comprehensive income (loss)	\$ 6,119	\$ 101,255	\$ (484)	\$ (105,198)	\$ 1,692

Table of Contents**Condensed Consolidating Statements of Operations****Nine Months Ended September 30, 2011**

	Parent/Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
<b>Revenue</b>	\$	\$ 3,057,139	\$	\$	\$ 3,057,139
<b>Costs, expenses and other</b>					
Cost of sales	15,658	2,382,406		(75,940)	2,322,124
Depreciation, depletion and amortization	2,051	318,269			320,320
Amortization of acquired sales contracts, net		(5,492)			(5,492)
Mine closure and asset impairment costs		7,316			7,316
Goodwill impairment					
Selling, general and administrative expenses	59,197	36,441	2,439	(5,328)	92,749
Change in fair value of coal derivatives and coal trading activities, net		9,248			9,248
Acquisition and transition costs related to ICG	46,044				46,044
Other operating (income) expense, net	(15,460)	(74,928)	102	81,268	(9,018)
	107,490	2,673,260	2,541		2,783,291
Income from investment in subsidiaries	388,253			(388,253)	
Income (loss) from operations	280,763	383,879	(2,541)	(388,253)	273,848
Interest expense, net:					
Interest expense	(172,699)	(34,858)	(1,535)	54,569	(154,523)
Interest income	11,644	40,576	4,690	(54,569)	2,341
	(161,055)	5,718	3,155		(152,182)
Other non-operating expense					
Bridge financing costs related to ICG	(49,490)				(49,490)
Net loss resulting from early retirement of debt		(1,958)			(1,958)
	(49,490)	(1,958)			(51,448)
Income (loss) before income taxes	70,218	387,639	614	(388,253)	70,218
Benefit from income taxes	(1,407)				(1,407)
Net income (loss)	71,625	387,639	614	(388,253)	71,625
Less: Net income attributable to noncontrolling interest	(822)				(822)
Net income (loss) attributable to Arch Coal, Inc.	\$ 70,803	\$ 387,639	\$ 614	\$ (388,253)	\$ 70,803
Total comprehensive income (loss)	\$ 72,511	\$ 379,390	\$ 614	\$ (388,253)	\$ 64,262



Table of Contents**Condensed Consolidating Balance Sheets****September 30, 2012**

	<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	\$ 313,548	\$ 225,431	\$ 11,777	\$	\$ 550,756
Restricted cash	3,450				3,450
Short term investments	99,359				99,359
Receivables	52,081	24,672	276,992	(4,997)	348,748
Inventories		391,526			391,526
Other	104,507	80,901	439		185,847
Total current assets	572,945	722,530	289,208	(4,997)	1,579,686
Property, plant and equipment, net	28,622	7,343,360	81		7,372,063
Investment in subsidiaries	8,503,465			(8,503,465)	
Intercompany receivables	(1,399,215)	1,561,073	(161,858)		
Note receivable from Arch Western	675,000			(675,000)	
Other	184,982	799,033	90		984,105
Total other assets	7,964,232	2,360,106	(161,768)	(9,178,465)	984,105
Total assets	\$ 8,565,799	\$ 10,425,996	\$ 127,521	\$ (9,183,462)	\$ 9,935,854
<b>Liabilities and Stockholders</b>					
<b>Equity</b>					
Accounts payable	\$ 35,157	\$ 269,203	\$ 82	\$	\$ 304,442
Accrued expenses and other current liabilities	92,337	269,834	1,772	(4,997)	358,946
Current maturities of debt and short-term borrowings	14,832	863	100,000		115,695
Total current liabilities	142,326	539,900	101,854	(4,997)	779,083
Long-term debt	4,463,386	2,059			4,465,445
Note payable to Arch Coal		675,000		(675,000)	
Asset retirement obligations	790	425,254			426,044
Accrued pension benefits	21,125	24,035			45,160
Accrued postretirement benefits other than pension	11,733	29,328			41,061
Accrued workers compensation	28,129	57,122			85,251
Deferred income taxes	665,414	80,665			746,079
Other noncurrent liabilities	67,629	114,557	278		182,464
Total liabilities	5,400,532	1,947,920	102,132	(679,997)	6,770,587
Redeemable noncontrolling interest					
Stockholders equity	3,165,267	8,478,076	25,389	(8,503,465)	3,165,267
Total liabilities and stockholders equity	\$ 8,565,799	\$ 10,425,996	\$ 127,521	\$ (9,183,462)	\$ 9,935,854

Table of Contents**Condensed Consolidating Balance Sheets**

December 31, 2011

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
<b>Assets</b>					
Cash and cash equivalents	\$ 61,375	\$ 75,425	\$ 1,349	\$	\$ 138,149
Restricted cash	10,322				10,322
Receivables	65,187	27,001	378,608	(1,617)	469,179
Inventories		377,490			377,490
Other	81,732	105,282	620		187,634
Total current assets	218,616	585,198	380,577	(1,617)	1,182,774
Property, plant and equipment, net	21,241	7,918,816	9,093		7,949,150
Investment in subsidiaries	8,805,731			(8,805,731)	
Intercompany receivables	(1,457,864)	1,716,424	(258,560)		
Note receivable from Arch Western	225,000			(225,000)	
Other	184,266	897,567	202		1,082,035
Total other assets	7,757,133	2,613,991	(258,358)	(9,030,731)	1,082,035
Total assets	\$ 7,996,990	\$ 11,118,005	\$ 131,312	\$ (9,032,348)	\$ 10,213,959
<b>Liabilities and Stockholders</b>					
<b>Equity</b>					
Accounts payable	\$ 25,409	\$ 358,347	\$ 26	\$	\$ 383,782
Accrued expenses and other current liabilities	75,133	282,434	85	(1,617)	356,035
Current maturities of debt and short-term borrowings	172,564	1,987	106,300		280,851
Total current liabilities	273,106	642,768	106,411	(1,617)	1,020,668
Long-term debt	3,308,674	453,623			3,762,297
Note payable to Arch Coal		225,000		(225,000)	
Asset retirement obligations	877	445,907			446,784
Accrued pension benefits	19,198	29,046			48,244
Accrued postretirement benefits other than pension	13,843	28,466			42,309
Accrued workers compensation	17,272	54,676			71,948
Deferred income taxes	621,483	355,270			976,753
Other noncurrent liabilities	152,963	102,335	84		255,382
Total liabilities	4,407,416	2,337,091	106,495	(226,617)	6,624,385
Redeemable noncontrolling interest	11,534				11,534
Stockholders equity	3,578,040	8,780,914	24,817	(8,805,731)	3,578,040
Total liabilities and stockholders equity	\$ 7,996,990	\$ 11,118,005	\$ 131,312	\$ (9,032,348)	\$ 10,213,959

Table of Contents**Condensed Consolidating Statements of Cash Flows****Nine Months Ended September 30, 2012**

	<b>Parent/Issuer</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries (In thousands)</b>	<b>Eliminations</b>	<b>Consolidated</b>
Cash provided by (used in) operating activities	\$ (500,331)	\$ 771,047	\$ 85,679	\$	\$ 356,395
<b>Investing Activities</b>					
Change in restricted cash	6,872				6,872
Capital expenditures	(4,150)	(299,818)			(303,968)
Proceeds from dispositions of property, plant and equipment		1,127	21,497		22,624
Investments in and advances to affiliates	(5,138)	(9,082)		1,535	(12,685)
Purchases of short term investments	(99,628)				(99,628)
Purchase of noncontrolling interest	(17,500)				(17,500)
Additions to prepaid royalties		(9,192)			(9,192)
Cash used in investing activities	(119,544)	(316,965)	21,497	1,535	(413,477)
<b>Financing Activities</b>					
Contributions from parent		1,535		(1,535)	
Proceeds from term note	1,386,000				1,386,000
Payments to retire debt		(452,806)			(452,806)
Net decrease in borrowings under lines of credit and commercial paper program	(381,300)				(381,300)
Payments on term note	(3,500)				(3,500)
Net payments on other debt	(13,078)				(13,078)
Debt financing costs	(34,640)		(46)		(34,686)
Dividends paid	(36,072)				(36,072)
Issuance of common stock under incentive plans	5,131				5,131
Transactions with affiliates, net	(50,493)	147,195	(96,702)		
Cash provided by (used in) financing activities	872,048	(304,076)	(96,748)	(1,535)	469,689
Increase in cash and cash equivalents	252,173	150,006	10,428		412,607
Cash and cash equivalents, beginning of period	61,375	75,425	1,349		138,149
Cash and cash equivalents, end of period	\$ 313,548	\$ 225,431	\$ 11,777	\$	\$ 550,756

Table of Contents**Condensed Consolidating Statements of Cash Flows****Nine Months Ended September 30, 2011**

	<b>Parent/Issuer</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries (In thousands)</b>	<b>Eliminations</b>	<b>Consolidated</b>
Cash provided by (used in) operating activities	\$ (444,664)	\$ 896,941	\$ 19,090	\$	\$ 471,367
<b>Investing Activities</b>					
Acquisition of ICG, net of cash acquired	(2,894,339)				(2,894,339)
Change in restricted cash	(5,939)				(5,939)
Capital expenditures	(5,137)	(210,660)	(102)		(215,899)
Proceeds from dispositions of property, plant and equipment		25,133			25,133
Investments in and advances to affiliates	(777,341)	(29,872)		750,386	(56,827)
Additions to prepaid royalties		(26,135)			(26,135)
Cash used in investing activities	(3,682,756)	(241,534)	(102)	750,386	(3,174,006)
<b>Financing Activities</b>					
Proceeds from the issuance of senior notes	2,000,000				2,000,000
Proceeds from the issuance of common stock, net	1,267,776				1,267,776
Contributions from parent		750,386		(750,386)	
Payments to retire debt		(604,096)			(604,096)
Net decrease in borrowings under lines of credit and commercial paper program	340,000	(56,904)			283,096
Net payments on other debt	(8,792)				(8,792)
Debt financing costs	(114,563)	(16)	(8)		(114,587)
Dividends paid	(57,470)				(57,470)
Issuance of common stock under incentive plans	1,628				1,628
Transactions with affiliates, net	742,906	(724,238)	(18,668)		
Cash provided by (used in) financing activities	4,171,485	(634,868)	(18,676)	(750,386)	2,767,555
Increase in cash and cash equivalents	44,065	20,539	312		64,916
Cash and cash equivalents, beginning of period	13,713	79,880			93,593
Cash and cash equivalents, end of period	\$ 57,778	\$ 100,419	\$ 312	\$	\$ 158,509

Table of Contents

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

**Overview**

Weakness in the U.S. thermal coal markets continued to impact our results in the third quarter of 2012. Coal stockpiles at generators remain at higher than normal levels, though levels declined during the quarter. Driving the weakness in the domestic thermal market during 2012 were an increase in the substitution of natural gas for coal as fuel for power generators and an unseasonably warm winter.

We also expect that thermal coal exports will somewhat offset the weakness in domestic markets. We exported over 10 million tons through the third quarter of 2012. More than half of these exports have been into Europe, with approximately 20% reaching Asia, and the remainder into the Americas. We expect China and India to import increasing volumes of metallurgical and thermal coal in the foreseeable future, even taking into account the potential for slower economic growth.

Metallurgical coal demand has been affected by weakening in the global and U.S. steel mill capacity utilization, due to slowing economic growth. Constraints resulting from the recession in Europe and slower-than-expected growth in China have affected consumer demand and reduced steel production and raw material consumption. Announced infrastructure spending in China and Brazil and stimulus spending in developed economies, when combined with global production curtailments, could benefit metallurgical markets in the future.

In response to these market conditions, we curtailed production and have taken steps to increase operational efficiency and productivity. In the Powder River Basin, two draglines remain idled, after we redeployed one into production in the third quarter. We have also limited railcar loadings from the West loadout at the Black Thunder mine and we have reduced labor costs through scheduling changes and attrition. In Appalachia, we closed or idled eight higher-cost operations and curtailed production at other mines. We are also controlling costs by eliminating discretionary spending, reducing headcount and consolidating operations. We are controlling capital spending at thermal coal mines, redeploying idle assets and reducing maintenance capital, but we are proceeding with metallurgical coal development projects, namely the Leer mine in Appalachia, and supporting efforts to expand our coal exporting network.

**Results of Operations**

*Items Affecting Comparability of Results*

The comparability of our operating results between the nine months ended September 30, 2012 and 2011 is also affected by the acquisition of ICG on June 15, 2011 and the mine closures and idlings and production curtailments mentioned previously.

*Three Months Ended September 30, 2012 Compared to Three Months Ended September 30, 2011*

## Edgar Filing: ARCH COAL INC - Form 10-Q

*Summary.* Our results during the third quarter of 2012, when compared to the third quarter of 2011, were impacted substantially by our mine closures and idlings and production curtailments in response to weak market conditions. In the third quarter of 2012, we also recognized a benefit from a reduction in a legal contingency liability of \$79.5 million.

*Revenues.* Our revenues consist of coal sales and revenues from our ADDCAR subsidiary acquired with ICG.

The following table summarizes information about coal sales during the three months ended September 30, 2012 and compares it with the information for the three months ended September 30, 2011:

	Three Months Ended September 30,		Increase (Decrease)	
	2012	2011	Amount	%
	(Amounts in thousands, except per ton data and percentages)			
Coal sales	\$ 1,087,266	\$ 1,196,540	\$ (109,274)	(9.1)%
Tons sold	37,549	40,301	(2,752)	(6.8)%
Coal sales realization per ton sold	\$ 28.96	\$ 29.69	\$ (0.73)	(2.5)%

Coal sales decreased in the third quarter of 2012 from the third quarter of 2011, primarily due to a decrease in sales volumes resulting from the operational changes we made in response to weak market conditions and a decrease in the overall average price per ton sold. Lower pricing was partially the result of a change in our regional mix towards volumes from our western operating segments and lower pricing on metallurgical coal sales due to product mix, which offset the impacts of slightly higher pricing on thermal coal sales and an increase in export shipments. Some exports are priced on a delivered basis,

## Edgar Filing: ARCH COAL INC - Form 10-Q

### Table of Contents

increasing the sales price, but also increasing our transportation costs (see cost of sales discussion below). 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 September 30, 2012 and compares it with the information for the three months ended September 30, 2011:

	Three Months Ended September 30,		Increase (Decrease) in Net Income	
	2012	2011	Amount	%
	(Amounts in thousands, except percentages)			
Cost of sales	\$ 896,809	\$ 952,850	\$ 56,041	5.9%
Depreciation, depletion and amortization	126,838	139,547	12,709	9.1%
Amortization of acquired sales contracts, net	(4,093)	(12,698)	(8,605)	67.8%
Change in fair value of coal derivatives and coal trading activities, net	5,840	8,360	2,520	30.1%
Selling, general and administrative expenses	33,266	33,275	9	
Legal contingencies	(79,532)		79,532	N/A
Mine closure and asset impairment costs	(2,194)		2,194	N/A
Acquisition and transition costs - ICG		4,694	4,694	100.0%
Other operating income, net	(25,276)	(3,611)	21,665	(600.0)%
	\$ 951,658	\$ 1,122,417	\$ 170,759	15.2%

*Cost of coal sales.* Our cost of sales decreased in the third quarter of 2012 from the third quarter of 2011 primarily due to the mine closures in the second quarter of 2012 and other market-related decreases in sales volumes, as well as a decrease in production costs at remaining operations, partially offset by an increase in transportation costs as a result of the increase in export shipments. We have provided more information about the performance and profitability of our operating segments under the heading *Operating segment results* .

*Depreciation, depletion and amortization.* When compared with the third quarter of 2011, depreciation, depletion and amortization costs decreased in 2012 as a result of the mine closures in Appalachia and lower depreciation and amortization on assets amortized or depleted on the basis of tons produced, processed, or sold.

*Amortization of acquired sales contracts, net.* The fair values of acquired sales contracts are amortized over the tons of coal shipped during the term of the contracts. Amortization income related to the contracts we acquired with ICG was lower in the third quarter of 2012 due to amortization in the third quarter of 2011 on contracts whose term ended in 2011.

*Change in fair value of coal derivatives and coal trading activities, net.* In the third quarter of 2012, previously recognized unrealized gains on API-2 positions were reclassified when the positions settled during the quarter. These positions manage our price risk on physical export sales into Europe, but are not accounted for as hedges, so the change in the positions' fair value prior to settlement is reflected in this line on the consolidated statement of operations, and then reclassified to other income, net when the positions settle.

## Edgar Filing: ARCH COAL INC - Form 10-Q

*Selling, general and administrative expenses.* Total selling, general and administrative expenses were consistent with the third quarter of 2011. The opening of sales offices in Singapore and London resulted in an increase in salary, benefit, and travel costs, which was offset by a decrease in incentive compensation costs.

*Legal contingencies.* As a result of a legal ruling in a lawsuit against former ICG subsidiaries, we changed our assessment of the probable loss related to the lawsuit. The suit is discussed in detail in Note 17 to the condensed consolidated financial statements in Part I, Item 1. Financial Statements of this Form 10-Q.

*Mine closure and asset impairment costs.* The termination of certain remaining employees at closed mining operations triggered the recognition of a gain on a postretirement benefit plan curtailment in the third quarter of 2012.

*Other operating income, net.* When compared with the three months ended September 30, 2011, the increase in other operating income, net for the three months ended September 30, 2012 was due to the gains on settlement of the API-2 positions discussed above, totaling \$13.9 million in the third quarter of 2012, and unrealized mark to market gains of \$8.8 million on



## Edgar Filing: ARCH COAL INC - Form 10-Q

### Table of Contents

our diesel risk management program. Because we do not apply hedge accounting to these positions, accounting rules do not allow the gains and losses from these activities to be recorded with the underlying activity in the statement of operations as if they qualified for hedge accounting.

*Operating segment results.* The following table shows results by operating segment for the three months ended September 30, 2012 and compares it with the information for the three months ended September 30, 2011:

	Three Months Ended September 30,		Increase (Decrease)	
	2012	2011	\$	%
<i>Powder River Basin</i>				
Tons sold (in thousands)	27,703	28,812	(1,109)	(3.8)%
Coal sales realization per ton sold(1)	\$ 13.79	\$ 13.62	\$ 0.17	1.2%
Operating margin per ton sold(2)	\$ 1.30	\$ 1.33	\$ (0.03)	(2.3)%
Adjusted EBITDA(3) (in thousands)	\$ 82,392	\$ 81,153	\$ 1,239	1.5%
<i>Appalachia</i>				
Tons sold (in thousands)	4,661	6,696	(2,035)	(30.4)%
Coal sales realization per ton sold(1)	\$ 83.84	\$ 84.32	\$ (0.48)	(0.6)%
Operating margin per ton sold(2)	\$ 2.23	\$ 9.32	\$ (7.09)	(76.1)%
Adjusted EBITDA(3) (in thousands)	\$ 143,919	\$ 111,004	\$ 32,915	29.7%
<i>Western Bituminous</i>				
Tons sold (in thousands)	4,580	4,233	347	8.2%
Coal sales realization per ton sold(1)	\$ 35.50	\$ 36.09	\$ (0.59)	(1.6)%
Operating margin per ton sold(2)	\$ 7.66	\$ 5.80	\$ 1.86	32.1%
Adjusted EBITDA(3) (in thousands)	\$ 53,479	\$ 43,778	\$ 9,701	22.2%

(1) These per-ton coal sales realizations reflect adjustments to exclude or include certain amounts to better represent the results we achieved within our operating segments. Since other companies may calculate these per ton amounts differently, our calculation may not be comparable to similarly titled measures used by those companies.

	Three Months Ended September 30,	
	2012	2011
Transportation costs passed to customers		
Powder River Basin	\$ 0.89	\$ 0.06
Appalachia	\$ 9.36	\$ 6.45
Western Bituminous	\$ 14.19	\$ 3.79
API-2 risk management position settlements not classified as revenues in statement of operations		
Appalachia	\$ 0.58	
Western Bituminous	\$ 2.11	

(2) Operating margin per ton sold is calculated as coal sales revenues less cost of coal sales, depreciation, depletion and amortization and sales contract 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 in the third quarter of 2012 remained flat when compared to the third quarter of 2011, despite the lower sales volumes in the Powder River Basin, due to higher realizations and lower overall costs. Higher per-ton production costs resulted from the lower production levels and higher diesel costs, which offset the impact of lower overall spending.

## Edgar Filing: ARCH COAL INC - Form 10-Q

### Table of Contents

*Appalachia* Segment Adjusted EBITDA benefited from a reduction of \$79.5 million in a legal contingency liability acquired with ICG, which offset the impact of market conditions and our resulting mine closures and idlings. Lower average coal sales realizations were the result of lower pricing on metallurgical coal sales, in part due to an increase in high-vol B and PCI shipments. Higher per-ton costs were impacted by higher depreciation, depletion and amortization costs, primarily due to the contribution from closed or idled operations. The full impact of the mine closures and idlings wasn't reflected in the third quarter of 2012, as shipments continued from inventories during the quarter. We expect the costs to maintain idled properties to eventually decrease to a level of approximately \$5 million per year.

*Western Bituminous* Segment Adjusted EBITDA increased from the third quarter of 2011 due to settlements on API-2 positions discussed previously in Change in fair value of derivatives and trading activities. Longwall moves impacted both quarters, though per-ton costs improved in the third quarter of 2012 due to higher shipment levels from lower cost mines.

*Net interest expense.* The increase in interest expense during the third quarter of 2012 when compared with the third quarter of 2011 is the result of the refinancing transactions in the second quarter of 2012, discussed in the Liquidity section.

*Other nonoperating expense.* Amounts reported as nonoperating consist of expenses resulting from financing activities, other than interest costs.

*Income taxes.* Our effective income tax rate is sensitive to changes in and the relationship between annual profitability and the deduction for percentage depletion.

### ***Nine Months Ended September 30, 2012 Compared to Nine Months Ended September 30, 2011***

*Summary.* Our results during the first nine months of 2012 when compared to the first nine months of 2011 were impacted substantially by our mine closures and idlings and production curtailments in response to weak market conditions and the impact of the ICG acquisition.

*Revenues.* Our revenues consist of coal sales and revenues from our ADDCAR subsidiary acquired with ICG.

The following table summarizes information about coal sales during the nine months ended September 30, 2012 and compares it with the information for the nine months ended September 30, 2011:

	Nine Months Ended September 30,		Increase (Decrease)	
	2012	2011	Amount	%
	(Amounts in thousands, except per ton data and percentages)			
Coal sales	\$ 3,190,807	\$ 3,057,139	\$ 133,668	4.4%
Tons sold	104,724	114,034	(9,310)	(8.2)%
Coal sales realization per ton sold	\$ 30.47	\$ 26.81	\$ 3.66	13.7%

Coal sales increased in 2012 from 2011, due to an increase in the overall average price per ton sold, the result of improved pricing on metallurgical-quality coal sold and the increase in export sales, as well as the contribution from the ICG operations, including higher-priced metallurgical coal sales volumes, as well as the impact of changes in regional mix on our average coal sales realization. These factors were offset by lower thermal coal demand in all operating segments which resulted in our decision to close or idle mining operations and curtail production. 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 nine months ended September 30, 2012 and compares it with the information for the nine months ended September 30, 2011:

## Edgar Filing: ARCH COAL INC - Form 10-Q

### Table of Contents

Cost of sales	\$2,628,939	\$2,322,124	\$(306,815)	(13.2)%
Depreciation, depletion and amortization	399,672	320,320	(79,352)	(24.8)%
Amortization of acquired sales contracts, net	(22,561)	(5,492)	17,069	(310.8)%
Change in fair value of coal derivatives and coal trading activities, net	(29,827)	9,248	39,075	422.5%
Selling, general and administrative expenses	99,305	92,749	(6,556)	7.1%
Legal contingencies	(79,532)		79,532	N/A
Mine closure and asset impairment costs	523,568	7,316	(516,252)	N/A
Goodwill impairment	115,791		(115,791)	N/A
Acquisition and transition costs - ICG		46,044	46,044	100.0%
Other operating income, net	(45,605)	(9,018)	36,587	(405.7)%
	\$3,589,750	\$2,783,291	\$(806,459)	(29.0)%

*Cost of coal sales.* Our cost of sales increased in 2012 from 2011 primarily from the impact of the acquisition of the ICG operations and an increase in transportation costs as a result of the increase in export shipments. These factors were partially offset by the impact of lower thermal coal demand in all operating segments which resulted in our decision to close or idle mining operations and curtail production. We have provided more information about the performance and profitability of our operating segments under the heading *Operating segment results*.

*Depreciation, depletion and amortization.* When compared with 2011, higher depreciation, depletion and amortization costs in 2012 resulted primarily from the acquired ICG operations, partially offset by the impact of lower depreciation and amortization on assets amortized or depleted on the basis of tons produced, processed, or sold.

*Amortization of acquired sales contracts, net.* The fair values of acquired sales contracts are amortized over the tons of coal shipped during the term of the contracts. In 2011, amortization income related to the contracts we acquired with the ICG operations was higher due to the amortization of contracts whose term ended in 2011. Offsetting the amortization of the ICG contracts in 2011 was expense of \$15.3 million related to contracts acquired with the Jacobs Ranch operations in the Powder River Basin in 2009.

*Change in fair value of coal derivatives and coal trading activities, net.* The gains reflected in 2012 relate primarily to API-2 positions entered into to manage price risk on physical export sales into Europe. These positions are not accounted for as hedges, so the change in the positions fair value prior to settlement is reflected in this line on the consolidated statement of operations, and then reclassified to other income, net when the positions settle.

*Selling, general and administrative expenses.* Selling, general and administrative expenses increased when compared with the first nine months of 2011 due to the opening of sales offices in Singapore and London, severance costs incurred in 2012, and an increase in fees for professional and legal services, partially offset by a decrease in incentive compensation costs of \$5.1 million.

*Legal Contingencies.* See explanation in the discussion of the results of operations for the three months ended September 30, 2012.

*Mine closure and asset impairment costs and goodwill impairment.* The following costs related to closed operations, primarily in Appalachia, are reflected in the line Mine closure and asset impairment costs for the nine months ended September 30, 2012 :

## Edgar Filing: ARCH COAL INC - Form 10-Q

### Table of Contents

	<b>In millions</b>
Parts and supplies inventory writedown	\$ 2.6
Impairment of property, plant and equipment	95.6
Impairment of coal properties and deferred development costs	403.3
Royalty obligations	11.5
Employee termination benefits	12.3
Pension, postretirement and occupational disease curtailment gain, net (see notes 13 and 14)	(1.8)
	<b>\$ 523.5</b>

*Goodwill Impairment.* We recorded a preliminary write-off of our goodwill related to our Black Thunder mining complex during the second quarter of 2012 due to expectations of lower thermal coal demand and its impact on near-term sales volumes and pricing. See further discussion in Note 6 to the condensed consolidated financial statements in Part I, Item 1. Financial Statements of this Form 10-Q.

*Other operating income, net.* When compared with the nine months ended September 30, 2011, the increase in other operating income, net for the nine months ended September 30, 2012 was primarily the result of gains on the settlement of coal derivative positions, primarily the API-2 positions discussed previously, totaling \$25.6 million in 2012, partially offset by unrealized mark to market losses of \$15.5 million on our diesel risk management program. Because we do not apply hedge accounting to these positions, accounting rules do not allow the gains and losses from these activities to be recorded with the underlying activity in the statement of operations as if they qualified for hedge accounting. Also, net commercial-related income increased \$10.5 million and gains on the sale of non-core assets increased \$11.6 million in 2012.

*Operating segment results.* The following table shows results by operating segment for the nine months ended September 30, 2012 and compares it with the information for the nine months ended September 30, 2011:

	<b>Nine Months Ended September 30,</b>		<b>Increase (Decrease)</b>	
	<b>2012</b>	<b>2011</b>	<b>\$</b>	<b>%</b>
<i>Powder River Basin</i>				
Tons sold (in thousands)	76,750	85,684	(8,934)	(10.4)%
Coal sales realization per ton sold(1)	\$ 13.78	\$ 13.61	\$ 0.17	1.2%
Operating margin per ton sold(2)	\$ 1.14	\$ 1.39	\$ (0.25)	(18.0)%
Adjusted EBITDA(3) (in thousands)	\$ 215,087	\$ 256,188	\$ (41,101)	(16.0)%
<i>Appalachia</i>				
Tons sold (in thousands)	14,528	14,556	(28)	(0.2)%
Coal sales realization per ton sold(1)	\$ 85.97	\$ 84.25	\$ 1.72	2.0%
Operating margin per ton sold(2)	\$ 3.11	\$ 14.33	\$ (11.22)	(78.3)%
Adjusted EBITDA(3) (in thousands)	\$ 324,683	\$ 318,203	\$ 6,480	2.0%
<i>Western Bituminous</i>				
Tons sold (in thousands)	11,825	13,141	(1,316)	(10.0)%
Coal sales realization per ton sold(1)	\$ 35.13	\$ 35.53	\$ (0.40)	(1.1)%
Operating margin per ton sold(2)	\$ 7.17	\$ 7.18	\$ (0.01)	(0.1)%
Adjusted EBITDA(3) (in thousands)	\$ 140,912	\$ 156,970	\$ (16,058)	(10.2)%

(1) These per-ton coal sales realizations reflect adjustments to exclude or include certain amounts to better represent the results we achieved within our operating segments. Since other companies may calculate these per ton amounts differently, our calculation may not be comparable to similarly titled measures used by those companies.





## Edgar Filing: ARCH COAL INC - Form 10-Q

### Table of Contents

	Nine Months Ended September 30,	
	2012	2011
Transportation costs passed to customers		
Powder River Basin	\$ 0.95	\$ 0.15
Appalachia	\$ 10.34	\$ 7.11
Western Bituminous	\$ 13.65	\$ 3.54
API-2 risk management position settlements not classified as revenues in statement of operations		
Appalachia	\$ 0.66	
Western Bituminous	\$ 1.25	

(2) Operating margin per ton sold is calculated as coal sales revenues less cost of coal sales, depreciation, depletion and amortization and sales contract 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 decreased in 2012 when compared to 2011, due to the lower sales volumes in the Powder River Basin from the production curtailments in response to market conditions. Per-ton costs were also higher due to the lower production levels, which offset the impact of higher per-ton selling prices.

*Appalachia* Segment Adjusted EBITDA in 2012 increased slightly when compared with 2011 as higher volumes and pricing of metallurgical coal and the reduction of \$79.5 million of a legal contingency liability acquired with ICG offset the impact of market conditions and our resulting mine closures and idlings. We sold 5.6 million tons of metallurgical-quality coal in 2012 compared to 5.2 million tons in 2011. The volume contributions from the acquired ICG operations were offset by the impact of unfavorable market conditions. The benefit from higher per-ton realizations, net of sales sensitive costs, in 2012 was offset by the impacts of lower production levels as a result of mine closures and other production rationalization, including an extended longwall move at the Mountain Laurel complex, which resulted in an increase in our average per-ton production costs. Mine closure and asset impairment costs are excluded from the per-ton costs and operating margins above, though the ongoing maintenance of those operations is included.

*Western Bituminous* Segment Adjusted EBITDA decreased from 2011 due to lower sales volumes and weaker demand in the region. Extended longwall moves during 2012, partially in response to market conditions, also impacted our results. The Skyline mine recommenced longwall mining late in October and the Dugout Canyon mine began mining in the current panel in August.

*Net interest expense.* The increase in interest expense during 2012 when compared with 2011 is the result of the ICG acquisition financing in 2011 and the refinancing transactions in the second quarter of 2012, discussed in the Liquidity section.

*Other nonoperating expense.* Amounts reported as nonoperating consist of expenses resulting from financing activities, other than interest costs. During 2012, nonoperating expense consists of the net loss resulting from the early retirement of \$450.0 million principal amount of our

## Edgar Filing: ARCH COAL INC - Form 10-Q

subsidiary's 6.75% Senior Notes due 2013. During 2011, nonoperating expense represents financing related costs of the ICG acquisition, including the cost to maintain a bridge financing facility, which was not utilized.

*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 income tax benefit in 2012 reflects our pretax loss combined with percentage depletion deductions.

### ***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

## Edgar Filing: ARCH COAL INC - Form 10-Q

### Table of Contents

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 we calculate Adjusted EBITDA.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Reported Segment Adjusted EBITDA	\$ 279,790	\$ 235,935	\$ 680,682	\$ 731,361
Corporate and other(1)	(23,279)	(24,477)	(63,423)	(80,622)
Adjusted EBITDA	256,511	211,458	617,259	650,739
Depreciation, depletion and amortization	(126,838)	(139,547)	(399,672)	(320,320)
Amortization of acquired sales contracts, net	4,093	12,698	22,561	5,492
Acquisition and transition costs		(8,584)		(55,569)
Mine closure and asset impairment costs	2,194		(523,568)	(7,316)
Goodwill impairment			(115,791)	
Other nonoperating expenses		(1,708)	(19,042)	(51,448)
Net interest expense	(74,251)	(76,854)	(225,642)	(152,182)
(Provision for) benefit from income taxes	(15,958)	11,427	255,363	1,407
Net income (loss) attributable to Arch Coal	\$ 45,751	\$ 8,890	\$ (388,532)	\$ 70,803

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

### **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 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 lines of credit. 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.

On May 16, 2012, we entered into an amendment to our senior secured revolving credit facility that amended certain financial maintenance covenants, suspending our compliance with the debt-to-EBITDA ratio, easing other financial covenants through September 2014 and adding defined minimum EBITDA targets. The maximum borrowing capacity of the revolving credit facility was reduced from \$2 billion to \$600 million. In conjunction with the amendment, we borrowed \$1.4 billion under a six-year secured term loan facility, issued at a 1% discount. The term loan contains no financial maintenance covenants, is prepayable and is secured by the same assets as borrowings under the revolving credit facility. Quarterly principal payments of \$3.5 million are due beginning in September 2012, plus interest at a rate of the greater of a LIBOR-based rate or 1.25%, plus 450 basis points. The proceeds of the term loan were used to retire all outstanding borrowings under the revolving credit facility and the outstanding \$450.0 million principal amount of 6.75% Senior Notes due 2013 issued by Arch Western Finance, LLC ( Arch Western Finance ), the Company's indirect subsidiary.

## Edgar Filing: ARCH COAL INC - Form 10-Q

On May 16, 2012, Arch Western Finance accepted for purchase approximately \$304.0 million in aggregate principal amount of its 6.75% Senior Notes due 2013 in an initial settlement pursuant to the terms of its tender offer and consent solicitation, which commenced on May 1, 2012, and called for redemption all of the remaining notes outstanding after the completion of the tender offer. The consideration for each \$1,000 of principal purchased under the tender offer and consent solicitation was \$1,002.50, for a total purchase consideration of \$304.8 million. On May 30, 2012, the remaining notes with an outstanding principal amount of \$146.0 million were redeemed at par value.

We believe that cash on hand, highly liquid investments, cash generated from operations, and borrowings under our credit facilities or other financing arrangements will be sufficient to meet working capital requirements and anticipated capital expenditures. As a result of the refinancing activities discussed previously, we have no significant debt maturities until 2016. 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.

## Edgar Filing: ARCH COAL INC - Form 10-Q

### Table of Contents

At September 30, 2012, we had cash on hand of \$550.8 million, \$99.4 million invested in highly liquid, interest-bearing securities and available borrowing capacity of approximately \$366 million under our lines of credit.

	September 30, 2012	December 31, 2011
	(In thousands)	
Indebtedness to banks under credit facilities	\$ 100,000	\$ 481,300
Term loan (\$1.4 billion face value) due 2018	1,383,375	
6.75% senior notes (\$450.0 million face value) due 2013		450,971
8.75% senior notes (\$600.0 million face value) due 2016	590,475	588,974
7.00% senior notes due 2019 at par	1,000,000	1,000,000
7.25% senior notes due 2020 at par	500,000	500,000
7.25% senior notes due 2021 at par	1,000,000	1,000,000
Other	7,290	21,903
	4,581,140	4,043,148
Less current maturities of debt and short-term borrowings	115,695	280,851
Long-term debt	\$ 4,465,445	\$ 3,762,297

The Company's average borrowing level under lines of credit and short term borrowings was approximately \$19 million and \$364 million for the three months ended September 30, 2012 and 2011, respectively and approximately \$267 million and \$194 million for the nine months ended September 30, 2012 and 2011, respectively.

The following is a summary of cash provided by or used in each of the indicated types of activities during the nine months ended September 30, 2012 and 2011.

	Nine Months Ended September 30,	
	2012	2011
	(Dollars in thousands)	
Cash provided by (used in):		
Operating activities	\$ 356,395	\$ 471,367
Investing activities	(413,477)	(3,174,006)
Financing activities	469,689	2,767,555

Cash provided by operating activities decreased in the first nine months of 2012 compared to 2011, driven by the decrease in our profitability resulting from poor market conditions.

We used less cash in investing activities in the first nine months of 2012 compared to the amount used in 2011, primarily due to the acquisition of ICG in 2011, as well as a decrease in investments in affiliates and prepaid royalties in 2012. This was offset by an increase during the nine months ended September 30, 2012 in capital expenditures of approximately \$88.1 million when compared with 2011. We spent approximately \$156.4 million during 2012 on the development of the Leer mine. In addition, during 2012, we invested approximately \$100 million of cash proceeds from the term loan in highly liquid marketable debt securities and we purchased the noncontrolling interest in Arch Western for \$17.5 million.

## Edgar Filing: ARCH COAL INC - Form 10-Q

Cash provided by financing activities was approximately \$470 million in the first nine months of 2012, compared to approximately \$2.8 billion in 2011. In 2011, the proceeds from the issuance of \$2.0 billion in senior notes in 2011 and an increase in shares outstanding as a result of the shares issued in 2011 were used to finance the ICG acquisition. In 2012, the proceeds from the \$1.4 billion term loan received in conjunction with the refinancing discussed previously were used, in part to retire the remaining outstanding senior secured notes due in 2013 and outstanding borrowings under lines of credit.

### **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:

Table of Contents

	Nine Months Ended September 30,	
	2012	2011
Ratio of earnings to combined fixed charges and preference dividends(1)	N/A(2)	1.36x

(1) Earnings consist of income from operations before income taxes and are adjusted to include only distributed income from affiliates accounted for on the equity method and fixed charges (excluding capitalized interest). Fixed charges consist of interest incurred on indebtedness, the portion of operating lease rentals deemed representative of the interest factor and the amortization of debt expense.

(2) Total losses for ratio calculation were \$405.7 million and total fixed charges were \$248.7 million for the nine months ended September 30, 2012.

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

We manage our commodity price risk for our non-trading, thermal coal sales through the use of long-term coal supply agreements, and to a limited extent, through the use of derivative instruments. Sales commitments in the metallurgical coal market are typically not long-term in nature, and we are therefore subject to the fluctuations in the market pricing. We expect to sell a total of approximately 7.5 million tons of metallurgical coal in 2012.

At September 30, 2012, our commitments for 2012 and 2013 are as follows:

	2012		2013	
	Tons	\$ per ton	Tons	\$ per ton
<b><u>Powder River Basin</u></b>				
Committed, Priced	105.7	\$ 13.63	70.0	\$ 14.14
Committed, Unpriced	0.4		10.9	
<b><u>Western Bituminous</u></b>				
Committed, Priced	14.9	\$ 35.75	10.7	\$ 39.10
Committed, Unpriced	0.2		0.6	
<b><u>Appalachia</u></b>				
Committed, Priced Thermal	10.9	\$ 66.26	4.4	\$ 62.12
Committed, Unpriced Thermal	0.3		0.3	
Committed, Priced Metallurgical	7.2	\$ 115.01	0.4	\$ 117.55
Committed, Unpriced Metallurgical	0.1		0.3	
<b><u>Illinois Basin</u></b>				
Committed, Priced	2.2	\$ 41.49	1.9	\$ 41.72

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 September 30, 2012. The estimated future realization of the value of the trading portfolio is \$3.6 million of gains in the remainder of 2012 and \$1.6 million of losses in 2013.

## Edgar Filing: ARCH COAL INC - Form 10-Q

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.



Table of Contents

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.

During the nine months ended September 30, 2012 VaR for our coal trading positions that are recorded at fair value through earnings ranged from under \$0.1 million to \$1.0 million. The linear mean of each daily VaR was \$0.4 million. The final VaR at September 30, 2012 was \$0.4 million.

We are exposed to fluctuations in the fair value of coal derivatives that we enter into to manage the price risk related to future coal sales, but for which we do not elect hedge accounting. Any gains or losses on these derivative instruments would be offset in the pricing of the physical coal sale. During the nine months ended September 30, 2012 VaR for our risk management positions that are recorded at fair value through earnings ranged from under \$1.3 million to \$4.2 million. The linear mean of each daily VaR was \$2.4 million. The final VaR at September 30, 2012 was \$1.4 million.

We are also exposed to the risk of fluctuations in cash flows related to our purchase of diesel fuel. We expect to use approximately 73 to 78 million gallons of diesel fuel for use in its operations during 2012. We enter into forward physical purchase contracts, as well as purchased heating oil options, to reduce volatility in the price of diesel fuel for our operations. At September 30, 2012, we had protected the price of approximately 80% of our expected purchases for the remainder of fiscal year 2012 and 67% of our 2013 purchases. A \$0.25 per gallon decrease in the price of heating oil would not result in an increase in our expense related to the heating oil derivatives.

We are exposed to market risk associated with interest rates due to our existing level of indebtedness. At September 30, 2012, of our \$4.6 billion principal amount of debt outstanding, approximately \$1.5 billion of outstanding borrowings have interest rates that fluctuate based on changes in the market rates. An increase in the interest rates related to these borrowings of 25 basis points would not result in an annualized increase in interest expense based on interest rates in effect at September 30, 2012.

**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 September 30, 2012. 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 our internal control over financial reporting during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

In addition to the following matters, 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**

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 ( Corps ), 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 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.

OVEC 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). The stay currently remains in effect.

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 reviewed the Recommended Determination issued by the EPA Region 3. By Memorandum Opinion and Order dated November 2, 2010, the court granted the United States' motion. On January 13, 2011, the 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 and by order dated March 21, 2011 stayed further proceedings in the case until further order of the court, in light of the challenge to the EPA's Final Determination currently pending in federal court in Washington, DC. As described more fully below, the federal court in Washington, DC, by Memorandum and Opinion and separate Order, each dated March 23,

Table of Contents

2012, granted Mingo Logan's motion for summary judgment, vacated EPA's Final Determination and found valid and in full force Mingo Logan's Section 404 permit. On April 5, 2012, Mingo Logan moved to lift the stay referenced above.

On June 5, 2012, the Court entered an order lifting the stay and allowing the case to proceed on Mingo Logan's Motion for Summary Judgment. Shortly thereafter, OVEC filed a motion for leave to file a seventh amended and supplemental complaint seeking to update existing counts and raising two new claims (one, to enforce EPA's Final Determination and, the other, that the Corps' refusal to prepare a Supplemental Environmental Impact Statement violates the APA and NEPA). By Memorandum, Opinion and Order dated July 25, 2012, the Court granted OVEC's motion and directed the Clerk to file OVEC's Seventh Amended and Supplemental Complaint.

Mingo Logan filed its Motion for Summary Judgment on August 31, 2012, along with its Answer to the Seventh Amended and Supplemental Complaint. All responses and replies to Mingo Logan's Motion have been filed and the matter is pending before the Court.

**EPA Actions Related to Water Discharges from the Spruce Permit**

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, the 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, the 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, the EPA Region 3 issued a Recommended Determination to the EPA Administrator recommending that the 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 the EPA as required by the regulations, to discuss corrective action to address the unacceptable adverse effects identified. On January 13, 2011, the 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 the EPA on April 2, 2010 in federal court in Washington, D.C. seeking a ruling that the 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.)). The EPA moved to dismiss that action, and we responded to that motion.

Pursuant to a scheduling order for summary disposition of the case, motions and cross-motions for summary judgment by both parties were filed. On November 30, 2011, the court heard arguments from the parties limited only to the threshold issue of whether the EPA had the authority under Section 404(c) of the Clean Water Act to withdraw the specification of the disposal site after the Corps had already issued a permit under Section 404(a). The court deferred consideration of the remaining issue (i.e. whether the EPA's Final Determination is otherwise lawful) until after consideration of the threshold issue. On March 23, 2012, the court entered an Order and a Memorandum Opinion granting Mingo Logan's motion for summary judgment, denying EPA's cross-motion for summary judgment, vacating the Final Determination and ordering that Mingo Logan's Section 404 permit remains valid and in full force.

Edgar Filing: ARCH COAL INC - Form 10-Q

On May 11, 2012, EPA filed a notice of appeal to the United States Court of Appeals for the District of Columbia Circuit. The parties have fully briefed the case and it is now pending further action by the Court.

Table of Contents

**Allegheny Energy Contract Matter**

Allegheny Energy Supply ( Allegheny ), the sole customer of coal produced at our 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 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 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 million and \$377 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 nondelivery 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 filed post-verdict motions in the trial court and on August 23, 2011, the court denied the parties motions. The court entered a final judgment on August 25, 2011, in the amount of \$104.1 million, which included pre-judgment interest. The parties appealed the lower court s decision to the Superior Court of Pennsylvania. On August 13, 2012, the Superior Court of Pennsylvania ruled that the lower court should have calculated damages as of the date of breach, and remanded the matter back to the lower court with instructions to recalculate the award.

**Saratoga Class Action Matter**

On January 7, 2008, Saratoga Advantage Trust ( Saratoga ) filed a class action lawsuit in the U.S. District Court for the Southern District of West Virginia against ICG and certain of its officers and directors seeking unspecified damages. The complaint asserts claims under

## Edgar Filing: ARCH COAL INC - Form 10-Q

Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder, based on alleged false and misleading statements in the registration statements filed in connection with ICG's November 2005 reorganization and December 2005 public offering of common stock. In addition, the complaint challenges other of ICG's public statements regarding its operating condition and safety record. On July 6, 2009, Saratoga filed an amended complaint asserting essentially the same claims but seeking to add an individual co-plaintiff. ICG has filed a motion to dismiss the amended complaint. In June 2011, ICG agreed to settle this matter for a total of \$1.375 million. On August 1, 2011, the court issued its order preliminarily approving settlement and conducted a settlement fairness hearing on November 14, 2011. On August 31, 2012, the court approved the settlement and dismissed the case with prejudice.

### **ICG Hazard**

The Sierra Club, on December 3, 2010, filed a Notice of Intent ( NOI ) to sue ICG Hazard, LLC ( Hazard ) alleging violations of the Clean Water Act and the Surface Mining Control and Reclamation Act of 1977 at Hazard's Thunder Ridge surface mine. The NOI, which was supplemented by a revised filing on February 24, 2011, claims that Hazard is discharging selenium and contributing to conductivity levels in the receiving streams in violation of state and federal regulations. On

Table of Contents

May 24, 2011, the Sierra Club sued Hazard in U.S. District Court for the Eastern District of Kentucky under the Citizens Suit provisions of the Clean Water Act and the Surface Mining Control and Reclamation Act seeking civil penalties, injunctive relief and attorneys' fees. On February 17, 2012, ICG Hazard filed a motion for summary judgment. Also on February 17, 2012, the Sierra Club filed a competing motion for summary judgment.

On September 28, 2012, the court entered a Memorandum Opinion and Order granting Hazard summary judgment on both Clean Water Act ( CWA ) and Surface Mining Control and Reclamation Act ( SMCRA ) claims finding that the CWA permit shield applies and that the SMCRA cannot be used to circumvent the CWA permit shield with respect to point source discharges. The court denied summary judgment to the extent the facts showed there were non-point source discharges from areas disturbed by surface mining activities. On October 4, 2012, the Sierra Club filed a Motion to Clarify Claims and Request Final Judgment Order notifying the court that all of its claims in the matter involved discharges from discrete point sources and that there remain no issues of law or fact that require court resolution. The motion requests the court enter a final judgment. The motion is pending before the Court.

**Kentucky Energy and Environment Cabinet**

On December 3, 2010, the Kentucky Energy and Environment Cabinet ( Cabinet ) filed suit against Hazard, ICG Knott County, LLC, ICG East Kentucky, LLC and Powell Mountain Energy, LLC (collectively, KY Operations ) alleging that the KY Operations failed to comply with the terms and conditions of the Kentucky Pollutant Discharge Elimination System ( KPDES ) permits issued by the Cabinet's Division of Water to the KY Operations. Among the claims lodged by the Cabinet were allegations that contract water monitoring laboratories retained by the KY Operations did not adhere to the practices and procedures required for conducting KPDES monitoring, the contract laboratories failed to properly document and maintain records of the monitoring and the KY Operations submitted quarterly Discharge Monitoring Reports that sometimes contained inaccurate, incomplete and erroneous information. The KY Operations and the Cabinet entered a proposed Consent Judgment contemporaneously with the filing of the complaint that, if approved by the Franklin County (KY) Circuit Court, will require the KY Operations to pay a monetary penalty of \$0.4 million, to prepare and implement a Corrective Action Plan that corrects the deficiencies in the respective KPDES monitoring programs, to identify the responsible corporate officers for each KPDES permit and to provide specific detailed information in support of the Discharge Monitoring Reports to be filed for the fourth quarter 2010 and first quarter 2011. On February 11, 2011, the court entered an order allowing certain anti-mining groups to intervene in the action to contest the validity of the Consent Judgment.

On October 10, 2012, the court approved and entered a consent judgment which was negotiated between all parties fully and finally resolving the matter pending before the court, as well as certain regulatory violations alleged by the Cabinet and the pending Citizens Suit identified below. The KY Operations agreed to pay a civil penalty in the amount of \$575,000, implement an auditing plan with respect to sampling and analysis of water quality, implement a corrective action plan related to use and function of contract laboratories and pay stipulated penalties for future water quality violations.

By letter dated June 28, 2011, Appalachian Voices, Inc., Waterkeeper Alliance, Inc., Kentuckians for the Commonwealth, Inc., Kentucky Riverkeeper, Inc., Ms. Pat Banks, Ms. Lanny Evans, Mr. Thomas H. Bonny, and Mr. Winston Merrill Combs (collectively, Appalachian Voices ) filed a NOI to sue the KY Operations for alleged violations of the Clean Water Act. The NOI claims that ICG has violated and continues to violate effluent standards or limitations under the Clean Water Act in reference to KPDES Coal General Permit. The NOI also alleges a lack of diligent prosecution related to the lawsuit filed by the Kentucky Energy and Environment Cabinet (as referenced and described above). On October 25, 2011, Appalachian Voices sued the KY Operations in U.S. District Court for the Eastern District of Kentucky under the Citizens Suit provisions of the Clean Water Act seeking civil penalties, injunctive relief and attorneys' fees. This case was dismissed with prejudice by Settlement Order filed on September 10, 2012.



**Patriot Coal Corporation Bankruptcy**

On December 31, 2005, Arch entered into a purchase and sale agreement with Magnum Coal Company ( Magnum ) to sell certain assets to Magnum. On July 23, 2008, Patriot Coal Corporation acquired Magnum. On July 9, 2012, Patriot Coal Corporation and certain of its wholly owned subsidiaries, including Magnum, (collectively, Patriot ) filed voluntary petitions for reorganization under Chapter 11 of the U.S. Code in the U.S. Bankruptcy Court for the Southern District of New York.

On September 20, 2012, Patriot filed a motion with the U.S. Bankruptcy Court for the Southern District of New York to reject a master coal sales and services agreement entered into on December 31, 2005 between us and Magnum, which was established in order to meet obligations under a coal sales and services agreement with a customer who did not consent to the assignment of their contract to Magnum. The underlying coal sales agreement provides the coal supplier with the ability to either ship coal or to elect to buy out of its monthly obligations at amounts that are predetermined for the remainder of the agreement. The Company believes that if the master coal sales and services agreement is rejected, it could source the underlying contract from a variety of alternative sources. The matter is currently pending before the court.

Table of Contents

**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 September 30, 2012, 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 September 30, 2012. Based on the closing price of our common stock as reported on the New York Stock Exchange on October 31, 2012, the approximate dollar value of our common stock that may yet be purchased under this program was \$87.0 million.

**Item 4. Mine Safety Disclosures**

The statement concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of Regulation S-K is included in Exhibit 95 to this Quarterly Report on Form 10-Q for the period ended September 30, 2012.

Table of Contents

**Item 6. Exhibits.**

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

- 4.1 Seventh Supplemental Indenture Governing 8.750% Senior Notes Due 2016 (incorporated herein by reference to Exhibit 4.1 to the registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2012).
- 4.2 Fifth Supplemental Indenture Governing 7¼% Senior Notes Due 2020 (incorporated herein by reference to Exhibit 4.2 to the registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2012).
- 4.3 Third Supplemental Indenture dated July 2, 2012 (incorporated herein by reference to Exhibit 4.3 to the registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2012).
- 4.4 Eighth Supplemental Indenture Governing 8.750% Senior Notes Due 2016 (incorporated herein by reference to Exhibit 4.4 to the registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2012).
- 4.5 Sixth Supplemental Indenture Governing 7¼% Senior Notes Due 2020 (incorporated herein by reference to Exhibit 4.5 to the registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2012).
- 4.6 Fourth Supplemental Indenture dated July 31, 2012 (incorporated herein by reference to Exhibit 4.6 to the registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2012).
- 12.1 Computation of ratio of earnings to combined fixed charges and preference dividends.
- 31.1 Certification of periodic financial report by Arch Coal, Inc.'s Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of periodic financial report by Arch Coal, Inc.'s Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of periodic financial report pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Arch Coal, Inc.'s Chief Executive Officer.
- 32.2 Certification of periodic financial report pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Arch Coal, Inc.'s Chief Financial Officer.
- 95 Mine Safety Disclosure Exhibit
- 101 Interactive Data File (Form 10-Q for the period ended September 30, 2012 filed in XBRL). The financial information contained in the XBRL-related documents is unaudited and unreviewed.

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 (On behalf  
of the registrant and as Principal Financial Officer)

November 8, 2012