ARCH COAL INC
Form 10-Q
November 09, 2011
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

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

For the transition period from to .

Commission file number: 1-13105

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**43-0921172** (I.R.S. Employer Identification Number)
One CityPlace Drive, Suite 300, St. Louis, Missouri (Address of principal executive offices)	**63141** (Zip code)

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

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

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 x No o

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 x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

At November 7, 2011 there were 211,618,197 shares of the registrant s common stock outstanding.

Table of Contents

Table of Contents

Table of Contents

Part I

FINANCIAL INFORMATION

Item 1. Financial Statements.

Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(in thousands, except per share data)

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
		(unaudited)		
REVENUES	$ 1,198,673	$ 874,705	$ 3,057,139	$ 2,350,874
COSTS, EXPENSES AND OTHER				
Cost of sales	952,850	651,853	2,322,124	1,773,464
Depreciation, depletion and amortization	123,026	92,857	301,746	269,135
Amortization of acquired sales contracts, net	(12,186)	10,038	(4,753)	26,005
Selling, general and administrative expenses	33,276	26,999	92,750	89,509
Change in fair value of coal derivatives and coal trading activities, net	8,360	1,832	9,248	12,296
Acquisition and transition costs related to ICG	4,694		53,360	
Gain on Knight Hawk transaction				(41,577)
Other operating income, net	(3,613)	(7,221)	(9,019)	(15,004)
	1,106,407	776,358	2,765,456	2,113,828
Income from operations	92,266	98,347	291,683	237,046
Interest expense, net:				
Interest expense	(77,694)	(37,698)	(154,523)	(107,906)
Interest income	840	927	2,341	1,888
	(76,854)	(36,771)	(152,182)	(106,018)
Other non-operating expense:				
Bridge financing costs related to ICG			(49,490)	
Net loss resulting from early retirement of debt	(1,708)	(6,776)	(1,958)	(6,776)
	(1,708)	(6,776)	(51,448)	(6,776)
Income before income taxes	13,704	54,800	88,053	124,252
Provision for (benefit from) income taxes	(5,583)	7,941	5,103	12,889
Net income	19,287	46,859	82,950	111,363
Less: Net income attributable to noncontrolling interest	(231)	(181)	(822)	(325)
Net income attributable to Arch Coal, Inc.	$ 19,056	$ 46,678	$ 82,128	$ 111,038

EARNINGS PER COMMON SHARE								
Basic earnings per common share	$	0.09	$	0.29	$	0.45	$	0.68
Diluted earnings per common share	$	0.09	$	0.29	$	0.45	$	0.68
Basic weighted average shares outstanding		211,337		162,391		182,898		162,384
Diluted weighted average shares outstanding		211,974		163,174		183,850		163,128
Dividends declared per common share	$	0.11	$	0.10	$	0.32	$	0.29

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, 2011 (unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 158,509	$ 93,593
Restricted cash	21,428	
Trade accounts receivable	342,721	208,060
Other receivables	83,579	44,260
Inventories	346,331	235,616
Prepaid royalties	29,163	33,932
Deferred income taxes	15,795	
Coal derivative assets	2,595	15,191
Other	107,462	104,262
Total current assets	1,107,583	734,914
Property, plant and equipment, net	7,703,280	3,308,892
Other assets:		
Prepaid royalties	96,869	66,525
Goodwill	539,963	114,963
Deferred income taxes	9,217	361,556
Equity investments	224,684	177,451
Other	173,665	116,468
Total other assets	1,044,398	836,963
Total assets	$ 9,855,261	$ 4,880,769
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 293,446	$ 198,216
Coal derivative liabilities	5,824	4,947
Deferred income taxes		7,775
Accrued expenses and other current liabilities	379,707	245,411
Current maturities of debt and short-term borrowings	47,156	70,997
Total current liabilities	726,133	527,346
Long-term debt	3,841,330	1,538,744
Asset retirement obligations	415,877	334,257
Accrued pension benefits	16,235	49,154
Accrued postretirement benefits other than pension	88,820	37,793
Accrued workers compensation	64,421	35,290
Deferred income taxes	880,487	
Other noncurrent liabilities	277,490	110,234
Total liabilities	6,310,793	2,632,818
Redeemable noncontrolling interest	11,261	10,444
Stockholders equity:		
Common stock, $0.01 par value, authorized 260,000 shares, issued 213,099 shares and 164,117 shares, respectively	2,135	1,645
Paid-in capital	3,012,628	1,734,709

Treasury stock, 1,512 shares at September 30, 2011 and December 31, 2010, at cost		(53,848)		(53,848)
Retained earnings		586,067		561,418
Accumulated other comprehensive loss		(13,775)		(6,417)
Total stockholders equity		3,533,207		2,237,507
Total liabilities and stockholders equity	$	9,855,261	$	4,880,769

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

Table of Contents

Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

	Nine Months Ended September 30 2011	2010
	(unaudited)	
OPERATING ACTIVITIES		
Net income	$ 82,950	$ 111,363
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, depletion and amortization	301,746	269,135
Amortization of acquired sales contracts, net	(4,753)	26,005
Bridge financing costs related to ICG	49,490	
Net loss resulting from early retirement of debt	1,958	6,776
Write down of assets acquired from ICG	7,316	
Prepaid royalties expensed	26,880	26,190
Employee stock-based compensation expense	9,019	9,640
Amortization relating to financing activities	9,854	6,630
Gain on Knight Hawk transaction		(41,577)
Changes in:		
Receivables	(35,874)	(48,718)
Inventories	(23,716)	21,818
Coal derivative assets and liabilities	15,199	14,116
Accounts payable, accrued expenses and other current liabilities	3,742	20,879
Income taxes, net	(21,971)	(1,923)
Deferred income taxes	23,572	(7,561)
Other	25,955	43,907
Cash provided by operating activities	471,367	456,680
INVESTING ACTIVITIES		
Acquisition of ICG, net of cash acquired	(2,894,339)	
Increase in restricted cash	(5,939)	
Capital expenditures	(215,899)	(221,583)
Proceeds from dispositions of property, plant and equipment	25,133	252
Purchases of investments and advances to affiliates	(56,827)	(16,740)
Additions to prepaid royalties	(26,135)	(23,715)
Cash used in investing activities	(3,174,006)	(261,786)
FINANCING ACTIVITIES		
Proceeds from the issuance of senior notes	2,000,000	500,000
Proceeds from the issuance of common stock, net	1,267,776	
Payments to retire debt	(604,096)	(505,627)
Net increase (decrease) in borrowings under lines of credit and commercial paper program	283,096	(118,337)
Net payments on other debt	(8,792)	(9,794)
Debt financing costs	(114,587)	(12,630)
Dividends paid	(57,470)	(47,121)
Issuance of common stock under incentive plans	1,628	339
Contribution from noncontrolling interest		891

Cash provided by (used in) financing activities		2,767,555		(192,279)
Increase in cash and cash equivalents		64,916		2,615
Cash and cash equivalents, beginning of period		93,593		61,138
Cash and cash equivalents, end of period	$	158,509	$	63,753

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 steam and metallurgical coal from surface and underground mines located throughout the United States, for sale to utility, industrial and export markets. On June 15, 2011, the Company acquired International Coal Group, Inc. (ICG), as described in Note 3, Business Combinations . The Company operates 23 mining complexes in West Virginia, Kentucky, Maryland, Virginia, Illinois, Wyoming, Colorado and Utah. All subsidiaries (except as noted below) are wholly-owned. Intercompany transactions and accounts have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial reporting and U.S. Securities and Exchange Commission regulations. In the opinion of management, all adjustments, consisting of normal, recurring accruals considered necessary for a fair presentation, have been included. Results of operations for the three and nine month periods ended September 30, 2011 are not necessarily indicative of results to be expected for the year ending December 31, 2011. These financial statements should be read in conjunction with the audited financial statements and related notes as of and for the year ended December 31, 2010 included in the Company s Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission.

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

2. Accounting Policies

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

3. Business Combination

On June 15, 2011, the Company completed its acquisition of ICG, a leading coal producer, operating 12 mining complexes in Appalachia and one complex in the Illinois Basin. In addition, one mine is currently under development in Appalachia. The Company acquired all of ICG s outstanding shares of common stock for $3.1 billion. To finance the acquisition, the Company received net proceeds of $1.25 billion from the sale of 48.0 million shares of its common stock and issued $2.0 billion in aggregate principal amount of senior unsecured notes. See Note 4, Equity Offering and Note 5, Debt and Financing Arrangements for further information about these transactions.

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

Table of Contents

		(In millions)
Consideration paid, net of cash acquired	$	2,894.4
Recognized amounts of net tangible and intangible assets acquired and liabilities assumed:		
Restricted cash		15.5
Receivables		114.2
Inventories		87.0
Net property, plant and equipment, including mineral rights		4,510.6
Goodwill		425.0
Other assets		49.2
Accounts payable		(82.6)
Other accrued expenses and current liabilities		(61.5)
Debt		(604.8)
Litigation accrual		(106.0)
Accrued postretirement benefits		(47.7)
Asset retirement obligation		(80.4)
Coal supply agreements, net		(98.8)
Deferred income taxes, net		(1,189.9)
Other		(35.4)
Net tangible and intangible assets acquired	$	2,894.4

During the third quarter of 2011, the following adjustments were made to the purchase price and the provisional fair values:

		(In millions)
Inventories		9.5
Net property, plant and equipment, including mineral rights		(5.8)
Coal supply agreements, net		(21.2)
Other		1.5
Purchase price adjustment cash received	$	(16.0)

The adjustments to the provisional fair values result from additional information obtained about facts in existence at the acquisition date. Adjustments to provisional fair values are assumed to have been made as of the acquisition date. As a result, cost of sales for the second quarter of 2011 would have been $5.6 million higher than was previously reported. The results in the condensed consolidated statements of income reflect this adjustment as if it had been recorded originally in the second quarter of 2011.

The Company s efforts to value the assets acquired and liabilities assumed are ongoing. Notably, the valuation report that will support the fair value of the fixed assets, coal reserves and goodwill acquired has not yet been completed. The estimated assigned value of goodwill in the table above represents the present value of the estimated synergies from the acquisition. The fair values above could change substantially when the valuation report is received.

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

The revenues and income before income taxes related to the acquired operations that have been included in the consolidated statements of income for the three months ended September 30, 2011 were $295.6 million and $34.9 million, respectively. The revenues and income before income taxes related to the acquired operations that have been included in the consolidated statements of income since the date of acquisition were $343.6 million and $43.6 million, respectively.

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

Table of Contents

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
	(In millions)			
Total revenues				
As reported	$ 1,198.7	$ 874.7	$ 3,057.1	$ 2,350.9
Pro forma	$ 1,198.7	$ 1,176.9	$ 3,596.8	$ 3,212.6
Income (loss) before income taxes				
As reported	$ 13.7	$ 54.8	$ 88.1	$ 124.3
Pro forma	$ 22.3	$ 47.5	$ 72.6	$ (66.9)

The pro forma income before income taxes includes adjustments to operating costs to reflect the new basis in assets acquired and interest expense to reflect the debt incurred to finance the acquisition. In addition, the following pre-tax costs and expenses reflected in the income before income taxes for the three and nine month periods ended September 30, 2011 reported in the condensed consolidated statement of income are reflected in the pro forma results as of January 1, 2010.

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
	(In thousands)	
Costs of completing the acquisition - Arch	$ 1,717	$ 29,569
Costs of completing the acquisition - ICG		23,503
Severance costs	2,977	16,475
Write off of acquired assets		7,316
Bridge financing fees		49,490
	$ 4,694	$ 126,353

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

Anticipated synergies are not reflected in the pro forma results.

In conjunction with the acquisition, the Company has $21.4 million of restricted cash at September 30, 2011 to provide collateral for ICG letters of credit until they can be eliminated or replaced and to fund change in control payments for executives and the board of directors.

4. Equity Offering

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

Table of Contents

5. Debt

	September 30, 2011	December 31, 2010
	(In thousands)	
Commercial paper	$	$ 56,904
Indebtedness to banks under credit facilities	340,000	
6.75% senior notes ($450.0 million face value) due July 1, 2013	451,132	451,618
8.75% senior notes ($600.0 million face value) due August 1, 2016	588,496	587,126
7.00% senior notes due June 15, 2019 at par	1,000,000	
7.25% senior notes due October 1, 2020 at par	500,000	500,000
7.25% senior notes due June 15, 2021 at par	1,000,000	
Other	8,858	14,093
	3,888,486	1,609,741
Less current maturities of debt and short-term borrowings	47,156	70,997
Long-term debt	$ 3,841,330	$ 1,538,744

The current maturities of debt include contractual maturities, as well as amounts borrowed that are supported by credit facilities that have a term of less than one year and amounts borrowed under credit facilities with terms longer than one year that the Company does not intend to refinance on a long-term basis, based on cash projections and management s plans.

2019 and 2021 Senior Notes

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

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

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

The Company and the guarantor subsidiaries entered into a registration rights agreement (the Registration Rights Agreement) in connection with the issuance and sale of the 2019 Notes and 2021 Notes. Pursuant to the Registration Rights Agreement, the Company and the guarantor subsidiaries agreed to file a registration statement with the Securities and Exchange Commission to register an exchange offer pursuant to which the Company will offer to exchange a like aggregate principal amount of senior notes identical in all material respects to the 2019 Notes and 2021 Notes, except for terms relating to additional interest and transfer restrictions, for any or all of the outstanding 2019 Notes and 2021 Notes. Pursuant to the Registration Rights Agreement, the Company must use commercially reasonable efforts to cause the registration statement to become effective as soon as practicable and to complete the exchange offer no later than June 13, 2012. Should those events not occur within the specified time frame, the applicable interest rates on the 2019 Notes and the 2021 Notes shall be increased by one-quarter of one percent per annum for the first 90 days following the occurrence of such failure. Such interest rate will increase by an additional one-quarter of one percent per annum thereafter at the end of each subsequent 90-day period up to a maximum aggregate increase of one percent per annum. Once any of the required events occur, the interest rates will revert to the rate specified in the indenture governing the 2019 Notes and 2021 Notes.

ICG Debt

Upon the closing of the ICG acquisition, the Company gave a 30-day redemption notice to the Trustee of ICG s 9.125% senior notes and legally discharged its obligation under the 9.125% senior notes by depositing $260.7 million with the Trustee to redeem the debt. On July 14, 2011, all of the outstanding 9.125% senior notes were redeemed at an aggregate price of $251.4 million, including the required make-whole premium, plus accrued interest of $5.2 million, and the remainder of the deposit was returned to the Company.

Table of Contents

At the acquisition date, ICG s 4.00% convertible senior notes with a fair value of $298.5 million and 9.00% convertible senior notes with a fair value of $1.7 million (convertible notes) became convertible into cash, pursuant to the amended indentures governing the convertible notes, at a calculated conversion rate of $2,614.6848 for each $1,000 in principal amount surrendered for conversion for the 4.00% convertible notes and $2,392.73414 for the 9.00% convertible notes for conversions occurring prior to August 17, 2011.

Other ICG debt, with a fair value of approximately $54.0 million at the acquisition date, consisted mainly of equipment notes and insurance notes payable.

The Company recognized net losses of $1.7 million and $2.0 million during the three and nine months ended September 30, 2011, respectively on the early extinguishment of ICG s debt, including the conversions of the 4.00% and 9.00% convertible notes described above. The remaining amounts outstanding under the convertible notes and other ICG debt is included in other in the debt table above.

Credit Facilities and Commercial Paper

On June 14, 2011, the Company amended and restated its secured credit facility to allow for up to $2.0 billion in borrowings. Borrowings under this credit facility bear interest at a floating rate based on LIBOR determined by reference to the Company s leverage ratio, as calculated in accordance with the credit agreement. The credit facility has a five-year term that expires on June 14, 2016 and is secured by substantially all of the Company s assets as well as its ownership interests in substantially all of its subsidiaries, excluding its ownership interests in Arch Western and its subsidiaries. Commitment fees of 0.50% per annum are payable on the average unused daily balance of the revolving credit facility. The Company paid and deferred $20.7 million in financing fees related to the amendment of this agreement. Financial covenant requirements may restrict the amount of unused capacity available to the Company for borrowings and letters of credit.

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

Availability

As of September 30, 2011 the Company had $300.0 million of borrowings outstanding under the amended and restated secured credit facility and $40.0 million of borrowings outstanding under its accounts receivable securitization program. As of September 30, 2011, the Company had availability of approximately $1.0 billion under all lines of credit, as limited by customary financial covenants that may limit the Company s total debt based on defined earnings measurements. The Company also had outstanding letters of credit of $141.0 million as of September 30, 2011.

6. Acquired Sales Contracts

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

	September 30, 2011		December 31, 2010	
	Assets	Liabilities	Assets	Liabilities
	(In thousands)		(In thousands)	
Acquired fair value	$ 145,213	$ 170,341	$ 114,453	$ 40,654
Accumulated amortization	(105,845)	(42,877)	(82,376)	(14,613)
Total	$ 39,368	$ 127,464	$ 32,077	$ 26,041
Net total		$ 88,096	$ 6,036	
Balance Sheet classification:				
Other current	$ 23,474	$ 58,049	$ 25,063	$ 5,615
Other noncurrent	$ 15,894	$ 69,415	$ 7,014	$ 20,426

Above-market contracts with a fair value of $30.8 million and below-market contracts with a fair value of $129.7 million were acquired from ICG. Of these amounts, $13.7 million and $52.3 million were classified as current assets and current liabilities, respectively, at September 30, 2011. See Note 3, Business Combinations for discussion of purchase price adjustments.

Table of Contents

The Company anticipates amortization income of all acquired sales contracts, based upon the fair value assigned to acquired ICG sales contracts and expected shipments in the next five years, to be approximately $29 million for the remainder of 2011, $20 million in 2012, $7 million in 2013, $8 million in 2014, $13 million in 2015 and $8 million in 2016.

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:

	Knight Hawk	DKRW	DTA	Tenaska (In thousands)	Millennium	Tongue River	Total
Balance at December 31, 2010	$ 131,250	$ 21,961	$ 14,472	$ 9,768	$	$	$ 177,451
Investments in affiliates				5,500	25,000	12,989	43,489
Advances to (distributions from) affiliates, net	(11,450)		4,394		1,900		(5,156)
Equity in comprehensive income (loss)	15,807	(1,631)	(3,713)	(2)	(1,561)		8,900
Balance at September 30, 2011	$ 135,607	$ 20,330	$ 15,153	$ 15,266	$ 25,339	$ 12,989	$ 224,684
Notes receivable from investees:							
Balance at December 31, 2010	$ 1,700	$ 18,100	$	$ 4,100	$	$	$ 23,900
Balance at September 30, 2011		28,417		4,777			33,194

In July 2011, the Company purchased a 33% membership interest in the Tongue River Holding Company, LLC (Tongue River) joint venture. Tongue River will construct and develop a railway line near Miles City, Montana and the Company s Otter Creek reserves. The Company has the right, upon completion of the railway line or under other prescribed circumstances, to require the other investors to purchase all of the Company s units in the venture at an amount equal to the capital contributions made by the Company at that time, less any distributions received.

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

The Company may be required to make future contingent payments of up to $70.9 million related to development financing for certain of its equity investees. The Company s obligation to make these payments, as well as the timing of any payments required, is contingent upon a number of factors, including project development progress, receipt of permits and construction financing.

8. Derivatives

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

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

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

Table of Contents

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 90 to 100 million gallons of diesel fuel for use in its operations during 2012. To reduce the volatility in the price of diesel fuel for its operations, the Company uses forward physical diesel purchase contracts, as well as heating oil swaps and purchased call options. At September 30, 2011, the Company had protected the price of approximately 70% of its expected purchases for the remainder of fiscal year 2011 and 55% for fiscal year 2012.

At September 30, 2011, the Company held heating oil swaps and purchased call options for approximately 68 million gallons for the purpose of managing the price risk associated with future diesel purchases. Since the changes in the price of heating oil highly correlate to changes in the price of the hedged diesel fuel purchases, the heating oil swaps and purchased call options qualify for cash flow hedge accounting.

The Company also purchased 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, 2011, Company held purchased call options for approximately 19.1 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 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, 2011, the Company held derivatives for risk management purposes totaling 0.5 million tons of coal sales and 0.5 million tons of coal purchases that are expected to settle during the remainder of 2011, 1.7 million tons of coal sales and 0.2 million tons of coal purchases that are expected to settle in 2012, 0.7 million tons of coal sales that are expected to settle in 2013, 1.4 million tons of coal sales that are expected to settle in 2014 and 0.7 million tons of coal sales that are expected to settle in 2015.

Coal trading positions

The Company may sell or purchase forward contracts, swaps and options in the over-the-counter coal market for trading purposes. The Company is exposed to the risk of changes in coal prices on the value of its coal trading portfolio. The estimated future realization of the value of the trading portfolio is $2.4 million of gains for the remainder of 2011, $0.9 million of losses in 2012 and $1.0 million of losses in 2013.

Tabular derivatives disclosures

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

Table of Contents

Fair Value of Derivatives

(in thousands)

	September 30, 2011			December 31, 2010		
	Asset Derivative	**Liability Derivative**		**Asset Derivative**	**Liability Derivative**	
Derivatives Designated as Hedging Instruments						
Heating oil diesel purchases	$ 9,352	$		$ 13,475	$	
Coal	2,708	(1,270)		2,009	(2,350)	
Total	12,060	(1,270)		15,484	(2,350)	
Derivatives Not Designated as Hedging Instruments						
Heating oil fuel surcharges	2,202					
Coal held for trading purposes	10,862	(10,365)		34,445	(24,087)	
Coal	1,812	(6,976)		1,139	(912)	
Total	14,876	(17,341)		35,584	(24,999)	
Total derivatives	26,936	(18,611)		51,068	(27,349)	
Effect of counterparty netting	(12,787)	12,787		(22,402)	22,402	
Net derivatives as classified in the balance sheets	**$ 14,149**	**$ (5,824)**	**$ 8,325**	**$ 28,666**	**$ (4,947)**	**$ 23,719**

Net derivatives as reflected on the balance sheets

		September 30, 2011	**December 31, 2010**
Heating oil	Other current assets	$ 11,554	$ 13,475
Coal	Coal derivative assets	2,595	15,191
	Coal derivative liabilities	(5,824)	(4,947)
		$ 8,325	**$ 23,719**

The Company had a current asset for the right to reclaim cash collateral of $10.7 million and $10.3 million at September 30, 2011 and December 31, 2010, respectively. These amounts are not included with the derivatives presented in the table above and are included in other current assets in the accompanying condensed consolidated balance sheets.

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

Three Months Ended September 30

(in thousands)

Derivatives used in Cash Flow Hedging Relationships	**Gain (Loss) Recognized in OCI (Effective Portion)**		**Gains (Losses) Reclassified from OCI into Income (Effective Portion)**		**Gain (Loss) Recognized in Income (Ineffective Portion and Amount Excluded from Effectiveness Testing)**	
	2011	**2010**	**2011**	**2010**	**2011**	**2010**
Heating oil diesel purchases	$ (6,386)	$ 3,052	$ 5,122**(2)**	$ 93**(2)**	$	$
Coal sales	1,820	1,500	466**(1)**	(226)**(1)**		
Coal purchases	(1,274)	(2,535)	**(2)**	(866)**(2)**		
Totals	$ (5,840)	$ 2,017	$ 5,588	$ (999)	$	$

13

Table of Contents

Derivatives Not Designated as Hedging Instruments		Gain (Loss) 2011		2010
Coal unrealized	$	(6,131)**(3)**	$	(993)**(3)**
Coal realized	$	166**(4)**	$	1,079**(4)**
Heating oil fuel surcharges unrealized	$	(2,501)**(4)**	$	**(4)**

Location in Statement of Income:

(1) Revenues

(2) Cost of sales

(3) Change in fair value of coal derivatives and coal trading activities, net

(4) Other operating income, net

During the three months ended September 30, 2011 and 2010, the Company recognized net unrealized and realized losses of $2.2 million and $0.8 million, respectively, related to its trading portfolio (including derivative and non-derivative contracts). These balances are included in the caption Change in fair value of coal derivatives and coal trading activities, net in the accompanying condensed consolidated statements of income and are not included in the previous table.

Nine Months Ended September 30

(in thousands)

Derivatives used in Cash Flow Hedging Relationships	Gain (Loss) Recognized in OCI (Effective Portion) 2011	2010	Gains (Losses) Reclassified from OCI into Income (Effective Portion) 2011	2010	Gain (Loss) Recognized in Income (Ineffective Portion and Amount Excluded from Effectiveness Testing) 2011	2010
Heating oil diesel purchases	$ 1,535	$ (5,508)	$ 14,946**(2)**	$ (211)**(2)**	$	$
Coal sales	4,570	(6,138)	790**(1)**	(1,556)**(1)**		
Coal purchases	(2,053)	5,534	**(2)**	(1,202)**(2)**		
Totals	$ 4,052	$ (6,112)	$ 15,736	$ (2,969)	$	$

Derivatives Not Designated as Hedging Instruments		Gain (Loss) 2011		2010
Coal unrealized	$	(7,550)**(3)**	$	(9,381)**(3)**
Coal realized	$	313**(4)**	$	3,931**(4)**
Heating oil fuel surcharges unrealized	$	(2,501)**(4)**	$	**(4)**

Location in Statement of Income:

(1) Revenues

(2) Cost of sales

(3) Change in fair value of coal derivatives and coal trading activities, net

(4) Other operating income, net

During the nine months ended September 30, 2011 and 2010, the Company recognized net unrealized and realized losses of $1.7 million and $2.9 million, respectively, related to its trading portfolio (including derivative and non-derivative contracts). These balances are included in the caption Change in fair value of coal derivatives and coal trading activities, net in the accompanying condensed consolidated statements of income and are not included in the previous table.

During the next twelve months, based on fair values at September 30, 2011, gains on derivative contracts designated as hedge instruments in cash flow hedges of approximately $9.3 million are expected to be reclassified from other comprehensive income into earnings.

Table of Contents

9. Inventories

Inventories consist of the following:

	September 30, 2011	December 31, 2010
	(In thousands)	
Coal	$ 180,988	$ 115,647
Repair parts and supplies, net of allowance	165,343	119,969
	$ 346,331	$ 235,616

The repair parts and supplies are stated net of an allowance for slow-moving and obsolete inventories of $13.4 million at September 30, 2011, and $12.7 million at December 31, 2010.

10. Fair Value Measurements

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

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

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

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

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

	Fair Value at September 30, 2011			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Assets:				
Investments in equity securities	$ 5,351	$ 5,351	$	$
Derivatives	14,149	1,018	2,695	10,436
Total assets	$ 19,500	$ 6,369	$ 2,695	$ 10,436
Liabilities:				
Derivatives	$ 5,824	$	$ (415)	$ 6,239

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, 2011	Nine Months Ended September 30, 2011
	(In thousands)	
Balance, beginning of period	$ 10,474	$ 9,183
Realized and unrealized losses recognized in earnings, net	(8,016)	(15,140)
Realized and unrealized losses recognized in other comprehensive income, net	(6,702)	(3,227)
Purchases	9,935	20,407
Issuances		(2,160)
Settlements	(1,494)	(4,866)
Balance, end of period	$ 4,197	$ 4,197

Net unrealized losses during the three and nine month periods ended September 30, 2011 related to level 3 financial instruments held on September 30, 2011 were $11.7 million and $14.7 million, respectively.

Table of Contents

Fair Value of Long-Term Debt

At September 30, 2011 and December 31, 2010, the fair value of the Company s senior notes and other long-term debt, including amounts classified as current, was $3.9 billion and $1.7 billion, respectively. Fair values are based upon observed prices in an active market when available or from valuation models using market information.

11. Stock-Based Compensation and Other Incentive Plans

During the nine months ended September 30, 2011, the Company granted options to purchase approximately 0.7 million shares of common stock with a weighted average exercise price of $32.18 per share and a weighted average grant-date fair value of $14.18 per share. The options fair value was determined using the Black-Scholes option pricing model, using a weighted average risk-free rate of 1.92%, a weighted average dividend yield of 1.25% and a weighted average volatility of 57.43%. The options expected life is 4.5 years and the options vest ratably over three years. The options provide for the continuation of vesting after retirement for recipients that meet certain criteria. The expense for these options will be recognized through the date that the employee first becomes eligible to retire and is no longer required to provide service to earn all or part of the award. The Company also granted 130,950 shares of restricted stock during the nine months ended September 30, 2011 at a weighted average grant-date fair value of $31.30 per share. The restricted stock vests after three years.

The Company has a long-term incentive program (LTI plan) 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 unpaid for all grants under the LTI plan totaled $10.0 million and $6.4 million as of September 30, 2011 and December 31, 2010, respectively.

The Company recognized compensation expense from all stock-based and LTI plans of $3.4 million for the three months ended September 30, 2011 and 2010, respectively. The Company recognized compensation expense from all stock-based and LTI plans of $12.6 million and $12.3 million for the nine months ended September 30, 2011 and 2010, respectively. These expenses are primarily included in selling, general and administrative expenses in the accompanying condensed consolidated statements of income.

12. Workers Compensation Expense

The following table details the components of workers compensation expense:

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Self-insured occupational disease benefits:				
Service cost	$ 807	$ 182	$ 1,246	$ 545
Interest cost	619	169	1,177	507

Net amortization		(109)		(465)		(370)		(1,395)
Total occupational disease		1,317		(114)		2,053		(343)
Traumatic injury claims and assessments		5,207		2,642		10,856		6,562
Total workers compensation expense	$	6,524	$	2,528	$	12,909	$	6,219

13. Employee Benefit Plans

The following table details the components of pension benefit costs:

	Three Months Ended September 30				Nine Months Ended September 30			
	2011		2010		2011		2010	
	(In thousands)				(In thousands)			
Service cost	$	4,122	$	3,967	$	12,367	$	11,902
Interest cost		4,063		3,955		12,190		11,866
Expected return on plan assets		(5,453)		(4,848)		(16,359)		(14,544)
Amortization of prior service cost (credit)		(47)		44		(142)		130
Amortization of other actuarial losses		2,187		1,782		6,561		5,348
Net benefit cost	$	4,872	$	4,900	$	14,617	$	14,702

Table of Contents

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Service cost	$ 1,493	$ 378	$ 2,416	$ 1,132
Interest cost	1,125	520	2,152	1,562
Amortization of prior service credits	(636)	(591)	(1,773)	(1,773)
Amortization of other actuarial gains	(775)	(729)	(2,325)	(2,188)
Net benefit cost (credit)	$ 1,207	$ (422)	$ 470	$ (1,267)

14. Comprehensive Income

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

The following table presents the components of comprehensive income:

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
	(In thousands)		(In thousands)	
Net income attributable to Arch Coal, Inc.	$ 19,056	$ 46,678	$ 82,128	$ 111,038
Other comprehensive income, net of income taxes:				
Pension, postretirement and other post-employment benefits, reclassifications into net income	388	28	1,254	84
Unrealized gains (losses) on available-for-sale securities	(569)	738	(1,256)	(178)
Unrealized gains and losses on derivatives, net of reclassifications into net income:				
Unrealized gains (losses) on derivatives	(3,671)	1,200	2,703	(3,889)
Reclassifications of (gains) losses into net income	(3,575)	639	(10,059)	1,856
Total comprehensive income	$ 11,629	$ 49,283	$ 74,770	$ 108,911

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:

[redacted]				
Weighted average shares outstanding:				
[redacted]				
Effect of common stock equivalents under incentive plans	637	783	952	744
[redacted]				

The effect of options to purchase 3.0 million and 3.4 million shares of common stock were excluded from the calculation of diluted weighted average shares outstanding for the three month periods ended September 30, 2011 and 2010, respectively, because the exercise price of these options exceeded the average market price of the Company s common stock for these periods. The effect of options to purchase 2.1 million and 2.7 million shares of common stock were excluded from the calculation of diluted weighted average shares outstanding for the nine month periods ended September 30, 2011 and 2010, respectively, because the exercise price of these options exceeded the average market price of the Company s common stock for these periods.

16. Guarantees

The Company has agreed to continue to provide surety bonds and letters of credit for the reclamation and retiree healthcare obligations of Magnum Coal Company (Magnum) related to the properties the Company sold to Magnum on December 31, 2005. Patriot Coal Corporation (Patriot) acquired Magnum in July 2008. The purchase agreement requires Magnum to reimburse the Company for costs related to the surety bonds and letters of credit and to use commercially reasonable efforts to replace the obligations. If the surety bonds and letters of credit related to the reclamation obligations are not replaced by Magnum within a specified period of time, Magnum must post a letter of credit in favor of the Company in the amounts of the reclamation obligations. As of September 30, 2011, Patriot has replaced $48.9 million of the surety bonds and has posted letters of credit of $32.7 million in the Company s favor. At September 30, 2011, the Company had $38.5 million of surety bonds remaining related to properties sold to

Table of Contents

Magnum. The surety bonding amounts are mandated by the state and are not directly related to the estimated cost to reclaim the properties.

Magnum also acquired certain coal supply contracts with customers who have not consented to the contracts assignment from the Company to Magnum. The Company has committed to purchase coal from Magnum to sell to those customers at the same price it is charging the customers for the sale. In addition, certain contracts were assigned to Magnum, but the Company has guaranteed Magnum s performance under the contracts. The longest of the coal supply contracts extends to the year 2017. If Magnum is unable to supply the coal for these coal sales contracts then the Company would be required to purchase coal on the open market or supply contracts from its existing operations. At market prices effective at September 30, 2011, the cost of purchasing 10.3 million tons of coal to supply the contracts that have not been assigned over their duration would exceed the sales price under the contracts by approximately $264.3 million, and the cost of purchasing 0.9 million tons of coal to supply the assigned and guaranteed contracts over their duration would exceed the sales price under the contracts by approximately $19.5 million. As the Company does not believe that it is probable that it would have to purchase replacement coal, no losses have been recorded in the consolidated financial statements as of September 30, 2011. However, if the Company would have to perform under these guarantees, it could potentially have a material adverse effect on the business, results of operations and financial condition of the Company.

In connection with the Company s acquisition of the coal operations of Atlantic Richfield Company (ARCO) and the simultaneous combination of the acquired ARCO operations and the Company s Wyoming operations into the Arch Western joint venture, the Company agreed to indemnify the other member of Arch Western against certain tax liabilities in the event that such liabilities arise prior to June 1, 2013 as a result of certain actions taken, including the sale or other disposition of certain properties of Arch Western, the repurchase of certain equity interests in Arch Western by Arch Western or the reduction under certain circumstances of indebtedness incurred by Arch Western in connection with the acquisition. If the Company were to become liable, the maximum amount of potential future tax payments is $22.3 million at September 30, 2011, which is not recorded as a liability in the Company s condensed consolidated financial statements. Since the indemnification is dependent upon the initiation of activities within the Company s control and the Company does not intend to initiate such activities, it is remote that the Company will become liable for any obligation related to this indemnification. However, if such indemnification obligation were to arise, it could potentially have a material adverse effect on the business, results of operations and financial condition of the Company.

17. Contingencies

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

Allegheny Energy Supply (Allegheny), the sole customer of coal produced at the Company s subsidiary Wolf Run Mining Company s (Wolf Run) Sycamore No. 2 mine, filed a lawsuit against Wolf Run, Hunter Ridge Holdings, Inc. (Hunter Ridge), and ICG in state court in Allegheny County, Pennsylvania on December 28, 2006, and amended its complaint on April 23, 2007. Allegheny claimed that Wolf Run breached a coal supply contract when it declared force majeure under the contract upon idling the Sycamore No. 2 mine in the third quarter of 2006, and that Wolf Run continued to breach the contract by failing to ship in volumes referenced in the contract. The Sycamore No. 2 mine was idled after encountering adverse geologic conditions and abandoned gas wells that were previously unidentified and unmapped. After extensive searching for gas wells and rehabilitation of the mine, it was re-opened in 2007, but with notice to Allegheny that it would necessarily operate at reduced volumes in order to safely and effectively avoid the many gas wells within the reserve. The amended complaint also alleged that the production stoppages constitute a breach of the guarantee agreement by Hunter Ridge and breach of certain representations made upon entering into the contract in early 2005. Allegheny voluntarily dropped the breach of representation claims later. Allegheny claimed that it would incur costs in 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. 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 damages calculations were significantly inflated because it did not seek to determine damages as of the time of the breach and in some instances artificially assumed future non-delivery or did not take into account the apparent requirement to

Table of Contents

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 Superior Court of Pennsylvania. Wolf Run and Hunter Ridge have filed an appeal bond in the amount of $124.9 million. Briefing is scheduled to begin on October 24, 2011, to be completed in early 2012.

As of September 30, 2011, the Company has accrued $106.7 million for this lawsuit, including $1.8 million of interest recognized post-acquisition. The ultimate resolution of this matter could result in an outcome which may be materially different than what the Company has accrued.

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

18. Segment Information

The Company has three reportable business segments, which are based on the major coal producing basins in which the Company operates. Each of these reportable business segments includes a number of mine complexes. The Company manages its coal sales by coal basin, not by individual mine complex. Geology, coal transportation routes to customers, regulatory environments and coal quality are characteristic to a basin. Accordingly, market and contract pricing have developed by coal basin. Mine operations are evaluated based on their per-ton operating costs (defined as including all mining costs but excluding pass-through transportation expenses), as well as on other non-financial measures, such as safety and environmental performance. The Company s reportable segments are the Powder River Basin (PRB) segment, with operations in Wyoming; the Western Bituminous (WBIT) segment, with operations in Utah, Colorado and southern Wyoming; the Appalachia (APP) segment, with operations in West Virginia, Kentucky, Maryland and Virginia. The Appalachia segment includes the acquired ICG operations in Appalachia, as well as the Company s previous Central Appalachia segment. The Other operating segment represents primarily the Company s Illinois operations and ADDCAR subsidiary, which manufactures and sells its patented highwall mining system.

Operating segment results for the three and nine months ended September 30, 2011 and 2010 are presented below. Results for the reportable segments include all direct costs of mining, including all depreciation, depletion and amortization related to the mining operations, even if the assets are not recorded at the operating segment level. See discussion of segment assets below. Corporate, Other and Eliminations includes the change in fair value of coal derivatives and coal trading activities, net; corporate overhead; land management; other support functions; and the elimination of intercompany transactions.

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

19

Table of Contents

	PRB	APP	WBIT	Other Operating Segments	Corporate, Other and Eliminations	Consolidated
			(In thousands)			
Three months ended September 30, 2011						
Revenues	$ 394,012	$ 611,403	$ 168,795	$ 24,463	$	$ 1,198,673
Income (loss) from operations	38,630	77,511	24,653	(1,713)	(46,815)	92,266
Depreciation, depletion and amortization	42,676	59,576	19,125	3,781	(2,132)	123,026
Amortization of acquired sales contracts, net	3,802	(16,022)		34		(12,186)
Capital expenditures	20,937	62,121	16,111	4,705	4,300	108,174
Three months ended September 30, 2010						
Revenues	$ 440,439	$ 296,227	$ 138,039	$	$	$ 874,705
Income from operations	51,787	55,664	14,816		(23,920)	98,347
Depreciation, depletion and amortization	49,005	24,435	18,940		477	92,857
Amortization of acquired sales contracts, net	10,038					10,038
Capital expenditures	8,164	16,910	20,703		3,848	49,625
Nine Months ended September 30, 2011						
Revenues	$ 1,178,537	$ 1,336,581	$ 513,388	$ 28,633	$	$ 3,057,139
Income (loss) from operations	121,119	224,561	95,218	(1,814)	(147,401)	291,683
Total assets	2,240,458	5,159,710	667,658	222,014	1,565,421	9,855,261
Depreciation, depletion and amortization	125,532	108,904	61,753	4,386	1,171	301,746
Amortization of acquired sales contracts, net	15,349	(20,145)		43		(4,753)
Capital expenditures	39,422	108,711	38,003	9,078	20,685	215,899
Nine months ended September 30, 2010						
Revenues	$ 1,170,353	$ 777,619	$ 402,902	$	$	$ 2,350,874
Income from operations	101,525	147,336	41,122		(52,937)	237,046
Total assets	2,304,277	701,670	677,968		1,150,871	4,834,786
Depreciation, depletion and amortization	138,059	72,190	57,700		1,186	269,135
Amortization of acquired sales contracts, net	26,005					26,005
Capital expenditures	12,614	41,519	54,507		112,943	221,583

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

	Three Months Ended September 30 2011	2010	Nine Months Ended September 30 2011	2010
	(In thousands)		(In thousands)	
Income from operations	$ 92,266	$ 98,347	$ 291,683	$ 237,046
Interest expense	(77,694)	(37,698)	(154,523)	(107,906)

Interest income	840	927	2,341	1,888
Bridge financing costs related to ICG			(49,490)	
Net loss resulting from early retirement of debt	(1,708)	(6,776)	(1,958)	(6,776)
Income before income taxes	$ 13,704	$ 54,800	$ 88,053	$ 124,252

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 unaudited 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 Western Resources, LLC and its subsidiaries, Arch Receivable Company, LLC and the Company s subsidiaries outside the U.S.):

Table of Contents

Condensed Consolidating Statements of Income

Three Months Ended September 30, 2011

(unaudited)

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Revenues	$	$ 651,326	$ 547,347	$	$ 1,198,673
Costs, expenses and other					
Cost of sales	7,442	522,636	448,680	(25,908)	952,850
Depreciation, depletion and amortization	718	83,775	38,533		123,026
Amortization of acquired sales contracts, net		(15,989)	3,803		(12,186)
Selling, general and administrative expenses	20,263	5,058	9,751	(1,796)	33,276
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	(6,063)	(30,509)	5,255	27,704	(3,613)
	27,054	573,331	506,022		1,106,407
Income from investment in subsidiaries	121,210			(121,210)	
Income from operations	94,156	77,995	41,325	(121,210)	92,266
Interest expense, net:					
Interest expense	(84,045)	(942)	(10,657)	17,950	(77,694)
Interest income	3,593	108	15,089	(17,950)	840
	(80,452)	(834)	4,432		(76,854)
Other non-operating expense					
Net loss resulting from early retirement of debt		(1,708)			(1,708)
		(1,708)			(1,708)
Income before income taxes	13,704	75,453	45,757	(121,210)	13,704
Benefit from income taxes	(5,583)				(5,583)
Net income	19,287	75,453	45,757	(121,210)	19,287
Less: Net income attributable to noncontrolling interest	(231)				(231)
Net income attributable to Arch Coal	$ 19,056	$ 75,453	$ 45,757	$ (121,210)	$ 19,056

Table of Contents

Condensed Consolidating Statements of Income

Three Months Ended September 30, 2010

(unaudited)

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Revenues	$	$ 324,507	$ 550,198	$	$ 874,705
Costs, expenses and other					
Cost of sales	3,578	229,731	445,814	(27,270)	651,853
Depreciation, depletion and amortization	794	52,302	39,761		92,857
Amortization of acquired sales contracts, net			10,038		10,038
Selling, general and administrative expenses	18,245	1,858	8,818	(1,922)	26,999
Change in fair value of coal derivatives and coal trading activities, net		1,832			1,832
Other operating (income) expense, net	(3,346)	(35,107)	2,040	29,192	(7,221)
	19,271	250,616	506,471		776,358
Income from investment in subsidiaries	108,974			(108,974)	
Income from operations	89,703	73,891	43,727	(108,974)	98,347
Interest expense, net:					
Interest expense	(38,041)	(745)	(16,738)	17,826	(37,698)
Interest income	3,138	119	15,496	(17,826)	927
	(34,903)	(626)	(1,242)		(36,771)
Other non-operating expense					
Net loss resulting from early retirement of debt			(6,776)		(6,776)
			(6,776)		(6,776)
Income before income taxes	54,800	73,265	35,709	(108,974)	54,800
Provision for income taxes	7,941				7,941
Net income	46,859	73,265	35,709	(108,974)	46,859
Less: Net income attributable to noncontrolling interest	(181)				(181)
Net income attributable to Arch Coal	$ 46,678	$ 73,265	$ 35,709	$ (108,974)	$ 46,678

Table of Contents

Condensed Consolidating Statements of Income

Nine Months Ended September 30, 2011

(unaudited)

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Revenues	$	$ 1,409,755	$ 1,647,384	$	$ 3,057,139
Costs, expenses and other					
Cost of sales	15,661	1,062,692	1,319,711	(75,940)	2,322,124
Depreciation, depletion and amortization	2,050	181,059	118,637		301,746
Amortization of acquired sales contracts, net		(20,102)	15,349		(4,753)
Selling, general and administrative expenses	59,198	10,112	28,768	(5,328)	92,750
Change in fair value of coal derivatives and coal trading activities, net		9,248			9,248
Acquisition and transition costs related to ICG	53,360				53,360
Other operating (income) expense, net	(15,461)	(87,210)	12,384	81,268	(9,019)
	114,808	1,155,799	1,494,849		2,765,456
Income from investment in subsidiaries	413,406			(413,406)	
Income from operations	298,598	253,956	152,535	(413,406)	291,683
Interest expense, net:					
Interest expense	(172,700)	(3,793)	(32,599)	54,569	(154,523)
Interest income	11,645	540	44,725	(54,569)	2,341
	(161,055)	(3,253)	12,126		(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 before income taxes	88,053	248,745	164,661	(413,406)	88,053
Provision for income taxes	5,103				5,103
Net income	82,950	248,745	164,661	(413,406)	82,950
Less: Net income attributable to noncontrolling interest	(822)				(822)
Net income attributable to Arch Coal	$ 82,128	$ 248,745	$ 164,661	$ (413,406)	$ 82,128

Table of Contents

Condensed Consolidating Statements of Income

Nine Months Ended September 30, 2010

(unaudited)

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Revenues	$	$ 846,351	$ 1,504,523	$	$ 2,350,874
Costs, expenses and other					
Cost of sales	8,554	591,692	1,239,893	(66,675)	1,773,464
Depreciation, depletion and amortization	2,270	142,961	123,904		269,135
Amortization of acquired sales contracts, net			26,005		26,005
Selling, general and administrative expenses	60,139	5,500	29,226	(5,356)	89,509
Change in fair value of coal derivatives and coal trading activities, net		12,296			12,296
Gain on Knight Hawk transaction		(41,577)			(41,577)
Other operating (income) expense, net	(8,124)	(84,031)	5,120	72,031	(15,004)
	62,839	626,841	1,424,148		2,113,828
Income from investment in subsidiaries	282,794			(282,794)	
Income from operations	219,955	219,510	80,375	(282,794)	237,046
Interest expense, net:					
Interest expense	(102,996)	(2,104)	(53,241)	50,435	(107,906)
Interest income	7,293	283	44,747	(50,435)	1,888
	(95,703)	(1,821)	(8,494)		(106,018)
Other non-operating expense					
Net loss resulting from early retirement of debt			(6,776)		(6,776)
			(6,776)		(6,776)
Income before income taxes	124,252	217,689	65,105	(282,794)	124,252
Provision for income taxes	12,889				12,889
Net income	111,363	217,689	65,105	(282,794)	111,363
Less: Net income attributable to noncontrolling interest	(325)				(325)
Net income attributable to Arch Coal	$ 111,038	$ 217,689	$ 65,105	$ (282,794)	$ 111,038

Table of Contents

Condensed Consolidating Balance Sheets

September 30, 2011

(unaudited)

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Assets					
Cash and cash equivalents	$ 57,778	$ 280	$ 100,451	$	$ 158,509
Restricted cash	21,428				21,428
Receivables	63,111	130,884	233,855	(1,550)	426,300
Inventories		173,564	172,767		346,331
Other	35,413	102,729	16,873		155,015
Total current assets	177,730	407,457	523,946	(1,550)	1,107,583
Property, plant and equipment, net	13,685	6,234,786	1,454,809		7,703,280
Investment in subsidiaries	8,632,002			(8,632,002)	
Intercompany receivables	(2,243,557)	813,061	1,430,496		
Note receivable from Arch Western	225,000			(225,000)	
Other	456,885	574,038	13,475		1,044,398
Total other assets	7,070,330	1,387,099	1,443,971	(8,857,002)	1,044,398
Total assets	$ 7,261,745	$ 8,029,342	$ 3,422,726	$ (8,858,552)	$ 9,855,261
Liabilities and Stockholders Equity					
Accounts payable	$ 33,646	$ 151,826	$ 107,974	$	$ 293,446
Accrued expenses and other current liabilities	108,442	132,785	145,854	(1,550)	385,531
Current maturities of debt and short-term borrowings	4,357	2,799	40,000		47,156
Total current liabilities	146,445	287,410	293,828	(1,550)	726,133
Long-term debt	3,388,496	1,702	451,132		3,841,330
Note payable to Arch Coal			225,000	(225,000)	
Asset retirement obligations	548	107,002	308,327		415,877
Accrued pension benefits	7,057	(489)	9,667		16,235
Accrued postretirement benefits other than pension	15,276	50,241	23,303		88,820
Accrued workers compensation	14,866	42,850	6,705		64,421
Deferred income taxes	(4,162)	884,649			880,487
Other noncurrent liabilities	148,751	75,565	53,174		277,490
Total liabilities	3,717,277	1,448,930	1,371,136	(226,550)	6,310,793
Redeemable noncontrolling interest	11,261				11,261
Stockholders equity	3,533,207	6,580,412	2,051,590	(8,632,002)	3,533,207
Total liabilities and stockholders equity	$ 7,261,745	$ 8,029,342	$ 3,422,726	$ (8,858,552)	$ 9,855,261

Table of Contents

Condensed Consolidating Balance Sheets

December 31, 2010

(unaudited)

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
			(In thousands)		
Assets					
Cash and cash equivalents	$ 13,713	$ 64	$ 79,816	$	$ 93,593
Receivables	31,458	12,740	210,075	(1,953)	252,320
Inventories		85,196	150,420		235,616
Other	29,575	102,375	21,435		153,385
Total current assets	74,746	200,375	461,746	(1,953)	734,914
Property, plant and equipment, net	9,817	1,800,578	1,498,497		3,308,892
Investment in subsidiaries	4,555,233			(4,555,233)	
Intercompany receivables	(1,807,902)	508,624	1,299,278		
Note receivable from Arch Western	225,000			(225,000)	
Other	481,345	344,698	10,920		836,963
Total other assets	3,453,676	853,322	1,310,198	(4,780,233)	836,963
Total assets	$ 3,538,239	$ 2,854,275	$ 3,270,441	$ (4,782,186)	$ 4,880,769
Liabilities and Stockholders Equity					
Accounts payable	$ 10,753	$ 65,793	$ 121,670	$	$ 198,216
Accrued expenses and other current liabilities	75,746	31,123	153,217	(1,953)	258,133
Current maturities of debt and short-term borrowings	14,093		56,904		70,997
Total current liabilities	100,592	96,916	331,791	(1,953)	527,346
Long-term debt	1,087,126		451,618		1,538,744
Note payable to Arch Coal			225,000	(225,000)	
Asset retirement obligations	873	32,029	301,355		334,257
Accrued pension benefits	20,843	4,407	23,904		49,154
Accrued postretirement benefits other than pension	14,284		23,509		37,793
Accrued workers compensation	15,383	13,805	6,102		35,290
Other noncurrent liabilities	51,187	22,135	36,912		110,234
Total liabilities	1,290,288	169,292	1,400,191	(226,953)	2,632,818
Redeemable noncontrolling interest	10,444				10,444
Stockholders equity	2,237,507	2,684,983	1,870,250	(4,555,233)	2,237,507
Total liabilities and stockholders equity	$ 3,538,239	$ 2,854,275	$ 3,270,441	$ (4,782,186)	$ 4,880,769

Table of Contents

Condensed Consolidating Statements of Cash Flows

Nine Months Ended September 30, 2011

(unaudited)

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Cash provided by (used in) operating activities	$ (444,664)	$ 613,179	$ 302,852	$	$ 471,367
Investing Activities					
Acquisition of ICG, net of cash acquired	(2,894,339)				(2,894,339)
Increase in restricted cash	(5,939)				(5,939)
Capital expenditures	(5,137)	(135,640)	(75,122)		(215,899)
Proceeds from dispositions of property, plant and equipment		25,010	123		25,133
Purchases of investments and advances to affiliates	(777,341)	(29,872)		750,386	(56,827)
Additions to prepaid royalties		(22,163)	(3,972)		(26,135)
Cash used in investing activities	(3,682,756)	(162,665)	(78,971)	750,386	(3,174,006)
Financing Activities					
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 increase (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)		(24)		(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	(596,588)	(146,318)		
Cash provided by (used in) financing activities	4,171,485	(450,298)	(203,246)	(750,386)	2,767,555
Increase in cash and cash equivalents	44,065	216	20,635		64,916
Cash and cash equivalents, beginning of period	13,713	64	79,816		93,593
Cash and cash equivalents, end of period	$ 57,778	$ 280	$ 100,451	$	$ 158,509

Table of Contents

Condensed Consolidating Statements of Cash Flows

Nine Months Ended September 30, 2010

(unaudited)

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidated
		(In thousands)		
Cash provided by (used in) operating activities	$ (224,066)	$ 404,836	$ 275,910	$ 456,680
Investing Activities				
Capital expenditures	(3,942)	(141,825)	(75,816)	(221,583)
Proceeds from dispositions of property, plant and equipment		178	74	252
Purchases of investments and advances to affiliates	(12,671)	(4,069)		(16,740)
Additions to prepaid royalties		(20,880)	(2,835)	(23,715)
Cash used in investing activities	(16,613)	(166,596)	(78,577)	(261,786)
Financing Activities				
Proceeds from the issuance of senior notes	500,000			500,000
Payments to retire debt			(505,627)	(505,627)
Net increase (decrease) in borrowings under lines of credit and commercial paper program	(120,000)		1,663	(118,337)
Net payments on other debt	(9,794)			(9,794)
Debt financing costs	(11,901)		(729)	(12,630)
Dividends paid	(47,121)			(47,121)
Issuance of common stock under incentive plans	339			339
Contribution from noncontrolling interest			891	891
Transactions with affiliates, net	(123,309)	(238,252)	361,561	
Cash provided by (used in) financing activities	188,214	(238,252)	(142,241)	(192,279)
Increase (decrease) in cash and cash equivalents	(52,465)	(12)	55,092	2,615
Cash and cash equivalents, beginning of period	54,255	64	6,819	61,138
Cash and cash equivalents, end of period	$ 1,790	$ 52	$ 61,911	$ 63,753

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

This document contains forward-looking statements that is, statements related to future, not past, events. In this context, forward-looking statements often address our expected future business and financial performance, and often contain words such as expects, anticipates, intends, plans, believes, seeks, or will. Forward-looking statements by their nature address matters that are, to different degrees, uncertain. For us, particular uncertainties arise from changes in the demand for our coal by the domestic electric generation industry; from legislation and regulations relating to the Clean Air Act and other environmental initiatives; from operational, geological, permit, labor and weather-related factors; from fluctuations in the amount of cash we generate from operations; from future integration of acquired businesses; and from numerous other matters of national, regional and global scale, including those of a political, economic, business, competitive or regulatory nature. These uncertainties may cause our actual future results to be materially different than those expressed in our forward-looking statements. We do not undertake to update our forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by law. For a description of some of the risks and uncertainties that may affect our future results, see Risk Factors in Part II of this Form 10-Q, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010 and in the Quarterly Reports on Form 10-Q that we have filed during interim periods.

Overview

Arch Coal is one of the world s largest coal producers by volume. We sell the majority of our coal as steam coal to power plants and industrial facilities. We also sell metallurgical coal used in steel production, a market that we expanded into further with the acquisition of International Coal Group, Inc. (ICG) in June 2011. On June 15, we acquired ICG s 1.1 billion ton, predominantly underground reserve base, of which nearly 30% is metallurgical-quality coal; twelve mining complexes and one development project in Appalachia, and one mining complex in Illinois. The acquisition of ICG adds low-cost, high-quality metallurgical coal to our product mix and creates substantial synergies with our existing operations, including blending opportunities, combining operations and reducing selling, general and administrative costs.

Growth in global coal demand combined with coal supply constraints in many traditional coal exporting countries have benefited coal markets in 2011. Global steel utilization has rebounded from recessionary levels, remaining strong in the third quarter of 2011. We expect metallurgical coal demand to increase in coming years to meet the increasing steel demand for infrastructure in both developing economies, such as China and Brazil, and mature economies, particularly Japan, where significant rebuilding will be necessary after the earthquake and tsunami.

As in metallurgical coal markets, U.S. steam coal is also migrating offshore to meet the continuing growth in global coal demand to fuel electricity generation. In response to global steam coal demand, we have expanded our seaborne sales and have shipped steam coal to Europe, South America, and Asia. Each of our operating segments is participating in the expansion of seaborne shipments, utilizing ports on the East and West Coasts as well through the Gulf of Mexico.

U.S. coal consumption has declined in 2011 due to strong contributions from other fuel sources, including higher hydroelectric power in the western U.S. and increased natural gas generation in the eastern part of the country. U.S. coal production in the first nine months of 2011 remained essentially flat versus the same period a year ago, according to MSHA data and company estimates. U.S. stockpile levels have declined approximately 30% from peak levels reached in November 2009. We estimate nationwide stockpiles reflected 55 days of supply at September 30, 2011, in line with the five-year average. We believe, however, that PRB-served power plant stockpiles were at below-normal levels, partly due to shipment disruptions in the region. Flooding of the Missouri and Mississippi rivers disrupted shipments in the Powder River Basin and the Illinois Basin during the second and third quarters of 2011, resulting in a loss of shipments from our PRB operations.

We encountered geologic issues encountered in the last panel of the seam we are currently mining at our Mountain Laurel mining complex, and experienced 45 days of lost longwall production there during the third quarter of 2011.

On November 3, 2011, we announced that we would be scaling back production at our Dugout Canyon mine in Utah, in response to weakness in demand for coal from that region. We plan to suspend longwall operations at the end of the current panel in the first half of 2012. The next potential longwall panel at Dugout Canyon has been developed and future decisions about production will be based on market conditions for Western Bituminous coal.

Table of Contents

Results of Operations

Three Months Ended September 30, 2011 Compared to Three Months Ended September 30, 2010

Summary. Our results during the third quarter of 2011 when compared to the third quarter of 2010 were impacted positively by the contribution from the acquired ICG operations and the impact of higher average sales realizations as a result of improved market conditions, but these factors were offset by the impact of lower volumes from our Mountain Laurel complex and the Powder River Basin.

Revenues. The following table summarizes information about coal sales during the three months ended September 30, 2011 and compares it with the information for the three months ended September 30, 2010:

	Three Months Ended September 30		Increase (Decrease)	
	2011	2010	Amount	%
	(Amounts in thousands, except per ton data and percentages)			
Coal sales	$ 1,198,673	$ 874,705	$ 323,968	37.0%
Tons sold	40,301	44,173	(3,872)	(8.8)%
Coal sales realization per ton sold	$ 29.74	$ 19.80	$ 9.94	50.2%

Coal sales increased in the third quarter of 2011 from the third quarter of 2010, primarily due to an increase in the overall average price per ton sold, the result of improved pricing on metallurgical-quality coal sold, the contribution from the ICG operations, including higher-priced metallurgical coal sales tons, and higher steam pricing in all regions, as well as the impact of changes in regional mix on our average coal sales realization. The contribution from the acquired ICG operations was $295.6 million of coal sales revenues for the third quarter of 2011. Overall sales volumes decreased as lower sales volumes in the Powder River Basin offset the increases in the Appalachia and Western Bituminous regions. 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, 2011 and compares it with the information for the three months ended September 30, 2010:

	Three Months Ended September 30		Increase (Decrease) in Net Income	
	2011	2010	$	%
	(Amounts in thousands, except percentages)			
Cost of coal sales	$ 952,850	$ 651,853	$ (300,997)	(46.2)%
Depreciation, depletion and amortization	123,026	92,857	(30,169)	(32.5)
Amortization of acquired sales contracts, net	(12,186)	10,038	22,224	221.4
Selling, general and administrative expenses	33,276	26,999	(6,277)	(23.2)
Change in fair value of coal derivatives and coal trading activities, net	8,360	1,832	(6,528)	(356.3)
Acquisition and transition costs related to ICG	4,694		(4,694)	N/A

Other operating income, net		(3,613)		(7,221)		(3,608)	50.0
	$	1,106,407	$	776,358	$	(330,049)	(42.5)%

Cost of coal sales. Our cost of coal sales increased in 2011 from 2010 primarily due to the acquisition of the ICG operations, an increase in transportation costs as a result of the increase in export shipments, and an increase in sales-sensitive costs. 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 2010, higher depreciation, depletion and amortization costs in 2011 resulted primarily from the acquisition of the ICG operations.

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 expense related to contracts we acquired in 2009 with the Jacobs Ranch operations in the PRB was offset by amortization income related to the contracts we acquired with the ICG operations. We estimate that net amortization income will be approximately $29 million in the fourth quarter of 2011, based on preliminary estimates of contract values and shipment levels, and we expect the amounts to drop off substantially in future years. These estimates could change substantially once the final contract valuations are completed.

Table of Contents

Selling, general and administrative expenses. The increase in selling, general and administrative expenses in the third quarter of 2011 when compared with the third quarter of 2010 is due primarily to higher compensation-related costs from an increase in headcount and an increase in fees for professional services, which were partially offset by a decrease in costs related to our deferred compensation plan due to improved investment performance.

Change in fair value of coal derivatives and coal trading activities, net. Net (gains) losses relate to the net impact of our coal trading activities and the change in fair value of other coal derivatives that have not been designated as hedge instruments in a hedging relationship. In 2011, decreasing coal prices resulted in unrealized losses on coal purchase contracts.

Acquisition and transition costs related to ICG. Expenses incurred during the quarter include severance costs of $3.0 million.

Other operating income, net. When compared with 2010, other operating income, net decreased in 2011 due to an increase in commercial-related expenses and a decrease in net income from equity method investees of $0.9 million, which offset $3.9 million of net operating income generated by acquired ICG operations, primarily royalties and ash disposal income.

Operating segment results. The following table shows results by operating segment for the three months ended September 30, 2011 and compares it with the information for the three months ended September 30, 2010:

	Three Months Ended September 30		Increase (Decrease)	
	2011	**2010**	**$**	**%**
Powder River Basin				
Tons sold (in thousands)	28,813	36,129	(7,316)	(20.3)%
Coal sales realization per ton sold(1)	$ 13.62	$ 12.12	$ 1.50	12.4%
Operating margin per ton sold(2)	$ 1.32	$ 1.41	$ (0.09)	(6.4)%
Adjusted EBITDA(3) (in thousands)	$ 83,131	$ 111,729	$ (28,598)	(25.6)%
Appalachia				
Tons sold (in thousands)	6,696	4,020	2,676	66.6%
Coal sales realization per ton sold(1)	$ 84.32	$ 69.29	$ 15.03	21.7%
Operating margin per ton sold(2)	$ 11.18	$ 13.34	$ (2.16)	(16.3)%
Adjusted EBITDA(3) (in thousands)	$ 113,973	$ 77,368	36,605	47.3%
Western Bituminous				
Tons sold (in thousands)	4,233	4,024	209	5.19%
Coal sales realization per ton sold(1)	$ 36.09	$ 34.16	$ 1.93	5.6%
Operating margin per ton sold(2)	$ 5.80	$ 3.61	$ 2.19	60.7%
Adjusted EBITDA(3) (in thousands)	$ 43,778	$ 33,756	$ 10,022	29.7%

(1) Coal sales prices per ton exclude certain transportation costs that we pass through to our customers. We use these financial measures because we believe the amounts as adjusted better represent the coal sales prices we achieved within our operating segments. Since other companies may calculate coal sales prices per ton differently, our calculation may not be comparable to similarly titled measures used by those companies. For the three months ended September 30, 2011, transportation costs per ton were $0.06 for the Powder River Basin, $6.99 for Appalachia, and $3.79 for the Western Bituminous region. For the three months ended September 30, 2010, transportation costs per ton were $0.07 for the Powder River Basin, $4.40 for Appalachia and $0.15 for the Western Bituminous region.

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

(3) Adjusted EBITDA is defined as net income attributable to the Company before the effect of net interest expense, income taxes, depreciation, depletion and amortization and the amortization of acquired sales contracts. Adjusted EBITDA is also adjusted for costs related to acquisitions and financing transactions. Segment Adjusted EBITDA is reconciled to net income at the end of this Results of Operations section.

Powder River Basin The decrease in Segment Adjusted EBITDA in the third quarter of 2011 when compared with the third quarter of 2010 is the result of lower sales volumes and higher production costs, partially offset by the impact of higher average coal sales realizations, which reflected the improved coal markets. The lower sales volumes were primarily the

Table of Contents

result of the flooding in the Midwest, but the third quarter of 2010 was also a record production quarter for us in the PRB. Higher per-ton production costs were the result lower production volumes and higher diesel prices and sales-sensitive costs.

Appalachia Segment Adjusted EBITDA in the third quarter of 2011 was higher than in 2010, primarily due to an increase in the volumes and pricing of metallurgical-quality coal sold. We sold approximately 2.1 million tons of metallurgical-quality coal in 2011 compared to 1.4 million tons in 2010. The volumes contributed by the acquired ICG operations were partially offset by lower volumes from the Mountain Laurel mine as a result of the geologic issues in the third quarter. The benefit from higher per-ton realizations in 2011, net of sales sensitive costs, and the acquisition of ICG was offset in part by the impacts of the Mountain Laurel longwall outage, and an increase in production at higher cost mines on our average per-ton production costs.

Western Bituminous The improvement in Segment Adjusted EBITDA in 2011 reflects higher sales volumes and improved pricing resulting from increased export shipments from our Colorado operations. Effective cost control in the region and slightly higher production levels reduced our per-ton operating costs, which also contributed to the improved results in 2011.

Net interest expense. The following table summarizes our net interest expense for the three months ended September 30, 2011 and compares it with the information for the three months ended September 30, 2010:

	Three Months Ended September 30		Increase (Decrease) in Net Income	
	2011	**2010**	**$**	**%**
	(Amounts in thousands, except percentages)			
Interest expense	$ (77,694)	$ (37,698)	$ (39,996)	(106.1)%
Interest income	840	927	(87)	(9.4)%
	$ (76,854)	$ (36,771)	$ (40,083)	(109.0)%

The increase in interest expense during 2011 when compared with 2010 is the result of the ICG acquisition financing. See further discussion in Liquidity and Capital Resources.

Income taxes. Our effective income tax rate is sensitive to changes in and the relationship between annual profitability and the deduction for percentage depletion. The following table summarizes our income taxes for three months ended September 30, 2011 and compares it with the information for the three months ended September 30, 2010:

	Three Months Ended September 30		Increase in Net Income	
	2011	**2010**	**$**	**%**
	(Amounts in thousands, except percentages)			
Provision for (benefit from) income taxes	$ (5,583)	$ 7,941	$ 13,524	170.3%

Nine Months ended September 30, 2011 Compared to Nine Months Ended September 30, 2010

Summary. Our results during the first nine months of 2011 when compared to the first nine months of 2010 were impacted positively by the contribution from the acquired ICG operations and higher average sales realizations as a result of improved market conditions, but these factors were offset by the acquisition, transition and financing costs necessary to complete the acquisition, as well as the impact of lower volumes from our Mountain Laurel complex and the Powder River Basin.

Revenues. The following table summarizes information about coal sales during the nine months ended September 30, 2011 and compares it with the information for the nine months ended September 30, 2010:

	Nine Months Ended September 30		Increase (Decrease)	
	2011	2010	Amount	%
	(Amounts in thousands, except per ton data and percentages)			
Coal sales	$ 3,057,139	$ 2,350,874	$ 706,265	30.0%
Tons sold	114,034	120,319	(6,285)	(5.2)%
Coal sales realization per ton sold	$ 26.81	$ 19.54	$ 7.27	37.2%

Coal sales increased in the first nine months of 2011 from the first nine months of 2010, due to an increase in the overall average price per ton sold, primarily from the effect of an increase in the volumes and pricing of metallurgical-quality coal

Table of Contents

sold, higher steam pricing in all regions and the impact of changes in regional mix on our average coal sales realization, in addition to the contribution from the ICG operations acquired. Overall sales volume decreased slightly as lower sales volumes in the Powder River Basin offset the increases in the Appalachia and Western Bituminous regions. 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, 2011 and compares it with the information for the nine months ended September 30, 2010:

	Nine Months Ended September 30		Increase (Decrease) in Net Income	
	2011	2010	$	%
	(Amounts in thousands, except percentages)			
Cost of coal sales	$ 2,322,124	$ 1,773,464	$ (548,660)	(30.9)%
Depreciation, depletion and amortization	301,746	269,135	(32,611)	(12.1)%
Amortization of acquired sales contracts, net	(4,753)	26,005	30,758	118.3%
Selling, general and administrative expenses	92,750	89,509	(3,241)	(3.6)%
Change in fair value of coal derivatives and coal trading activities, net	9,248	12,296	3,048	24.8%
Acquisition and transition costs related to ICG	53,360		(53,360)	N/A
Gain on Knight Hawk transaction		(41,577)	(41,577)	(100.0)%
Other operating income, net	(9,019)	(15,004)	(5,985)	(39.9)%
	$ 2,765,456	$ 2,113,828	$ (651,628)	(30.8)%

Cost of coal sales. Our cost of coal sales increased in 2011 from 2010 primarily due to the acquisition of the ICG operations, an increase in transportation costs as a result of the increase in export shipments, and an increase in sales-sensitive costs. 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 2010, higher depreciation, depletion and amortization costs in 2011 resulted primarily from the acquired ICG operations, offset by the impact of lower depreciation and amortization on assets amortized or depleted on the basis of tons produced.

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 expense related to contracts we acquired in 2009 with the Jacobs Ranch operations in the PRB was offset by amortization income related to the contracts we acquired with the ICG operations. We estimate that net amortization income will be approximately $29 million in the fourth quarter of 2011, based on preliminary estimates of contract values and shipment levels, though we expect the amounts to drop off substantially in future years. These estimates could change substantially once the final contract valuations are completed.

Selling, general and administrative expenses. The increase in selling, general and administrative expenses in 2011 is due primarily to higher compensation-related costs from an increase in headcount and an increase in professional services fees. These increases were partially offset by a decrease in charitable contributions related to a payment to the Arch Coal Foundation of $5.0 million in 2010 and a decrease in costs related to our deferred compensation plan due to improved investment performance.

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

Acquisition and transition costs related to ICG. Expenses represent costs to complete the acquisition of $29.5 million, severance costs of $16.5 million and the write off of the $7.3 million value of a preparation plant and loadout of an acquired ICG mining operation that has been combined with an existing operation of the Company, and utilizes an existing facility.

Gain on Knight Hawk transaction. Represents the gain recognized on our exchange of Illinois Basin reserves in 2010 for an additional ownership interest in Knight Hawk, an equity method investee operating in the Illinois Basin.

Other operating income, net. When compared with 2010, other operating income, net decreased in 2011 due to an increase in commercial-related expenses in 2011, partially offset by $5.3 million of other income generated by acquired ICG

Table of Contents

operations, primarily royalties and ash disposal income, and an increase in net income from equity method investees of $0.8 million.

Operating segment results. The following table shows results by operating segment for the nine months ended September 30, 2011 and compares it with the information for the nine months ended September 30, 2010:

	Nine Months Ended September 30		Increase (Decrease)	
	2011	**2010**	**$**	**%**
Powder River Basin				
Tons sold (in thousands)	85,684	97,725	(12,041)	(12.3)%
Coal sales realization per ton sold(1)	$ 13.61	$ 11.90	$ 1.71	14.4%
Operating margin per ton sold(2)	$ 1.39	$ 1.02	$ 0.37	36.3%
Adjusted EBITDA(3) (in thousands)	$ 259,094	$ 263,911	$ (4,871)	(1.8)%
Appalachia				
Tons sold (in thousands)	14,556	10,445	4,111	39.4%
Coal sales realization per ton sold(1)	$ 84.25	$ 69.12	$ 15.13	21.9%
Operating margin per ton sold(2)	$ 15.60	$ 13.56	$ 2.04	15.0%
Adjusted EBITDA(3) (in thousands)	$ 315,610	$ 208,908	$ 106,702	51.1%
Western Bituminous				
Tons sold (in thousands)	13,141	12,149	992	8.2%
Coal sales realization per ton sold(1)	$ 35.47	$ 33.01	$ 2.46	7.5%
Operating margin per ton sold(2)	$ 7.18	$ 3.10	$ 4.08	131.6%
Adjusted EBITDA(3) (in thousands)	$ 156,970	$ 98,822	$ 58,148	58.8%

(1) Coal sales prices per ton exclude certain transportation costs that we pass through to our customers. We use these financial measures because we believe the amounts as adjusted better represent the coal sales prices we achieved within our operating segments. Since other companies may calculate coal sales prices per ton differently, our calculation may not be comparable to similarly titled measures used by those companies. For the nine months ended September 30, 2011, transportation costs per ton were $0.15 for the Powder River Basin, $7.57 for Appalachia and $3.54 for the Western Bituminous region. For the nine months ended September 30, 2010, transportation costs per ton were $0.08 for the Powder River Basin, $5.33 for Appalachia and $0.15 for the Western Bituminous region.

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

(3) Adjusted EBITDA is defined as net income attributable to the Company before the effect of net interest expense, income taxes, depreciation, depletion and amortization and the amortization of acquired sales contracts. Adjusted EBITDA is also adjusted for costs related to acquisitions and financing transactions. Segment Adjusted EBITDA is reconciled to net income at the end of this Results of Operations section.

Powder River Basin Segment Adjusted EBITDA was slightly lower in 2011 when compared to 2010, primarily the result of the decrease in sales volumes in the Powder River Basin in 2011 when compared with 2010, due to the flooding in the Midwest and a market-driven approach to sales commitments earlier in the year , as well as higher per-ton production costs. Higher production costs reflected an increase in labor, maintenance and diesel costs and an increase in sales-sensitive costs, due to the increased realizations, as well as the lower production volumes. Higher average coal sales realizations, reflecting the improved coal markets partially offset the impact of the lower volumes and higher per-ton costs

Appalachia Segment Adjusted EBITDA increased from 2010 primarily from an increase in the volumes and pricing of metallurgical-quality coal sold and the acquisition of ICG. The contribution from acquired ICG and other Arch mines made up the volume impact from the geology issues at the Mountain Laurel mine. We sold 5.3 million tons of metallurgical-quality coal in 2011 compared to 3.8 million tons in 2010. The benefit from higher per-ton realizations in 2011, net of sales sensitive costs, drove the improvement in our operating margins over 2010, partially offset by the impacts of the Mountain Laurel geology issues, and an increase in production at higher cost mines on our average per-ton production costs.

Western Bituminous Improved Segment Adjusted EBITDA reflects higher sales volumes and improved pricing resulting from increased export shipments for coal from our Colorado operations. Effective cost control in the region and slightly higher production levels reduced our per-ton operating costs, which also contributed to the improved results in 2011, when compared with the first nine months of 2010, when two outages affected production at the Dugout Canyon mine.

Table of Contents

Net interest expense. The following table summarizes our net interest expense for the nine months ended September 30, 2011 and compares it with the information for the nine months ended September 30, 2010:

	Nine Months Ended September 30		Increase (Decrease) in Net Income	
	2011	2010	$	%
	(Amounts in thousands, except percentages)			
Interest expense	$ (154,523)	$ (107,906)	$ (46,617)	(43.2)%
Interest income	2,341	1,888	453	24.0%
	$ (152,182)	$ (106,018)	$ (46,164)	(43.5)%

The increase in interest expense during 2011 when compared with 2010 is the result of the ICG acquisition financing. See further discussion in Liquidity and Capital Resources.

Other non-operating expense. The following table summarizes other non-operating expenses for the nine months ended September 30, 2011 and compares them with the information for the nine months ended September 30, 2010:

	Nine Months Ended September 30		Decrease in Net Income
	2011	2010	$
	(Amounts in thousands, except percentages)		
Bridge financing costs related to ICG	$ (49,490)	$	$ (49,490)
Net loss resulting from early retirement of ICG debt	(1,958)		(1,958)
	$ (51,448)	$	$ (51,448)

Other non-operating expenses during the third quarter of 2011 represent financing-related costs of the ICG acquisition, including the cost to maintain a bridge financing facility, which was not used.

Income taxes. Our effective income tax rate is sensitive to changes in and the relationship between annual profitability and the deduction for percentage depletion. The following table summarizes our income taxes for nine months ended September 30, 2011 and compares it with the information for the nine months ended September 30, 2010:

	Nine Months Ended September 30		Increase in Net Income	
	2011	2010	$	%
	(Amounts in thousands, except percentages)			
Provision for income taxes	$ 5,103	$ 12,889	$ 7,786	60.4%

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 is also adjusted for costs related to acquisitions and financing transactions. We believe that Adjusted EBITDA presents a useful measure of our ability to service and incur debt based on ongoing operations. Investors should be aware that our presentation of Adjusted EBITDA may not be comparable to similarly titled measures used by other companies. The table below shows how we reconcile Adjusted EBITDA to net income attributable to Arch Coal.

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	**2010**	**2011**	**2010**
Reported Segment Adjusted EBITDA	$ 240,882	$ 222,853	$ 731,674	$ 571,641
Corporate and other (1)	(29,423)	(21,792)	(80,935)	(39,780)
Adjusted EBITDA	211,459	201,061	650,739	531,861
Depreciation, depletion and amortization	(123,026)	(92,857)	(301,746)	(269,135)
Amortization of acquired sales contracts, net	12,186	(10,038)	4,753	(26,005)
Interest expense	(77,694)	(37,698)	(154,523)	(107,906)
Interest income	840	927	2,341	1,888
Acquisition and transition costs (2)	(8,584)		(62,885)	
Bridge financing costs related to ICG			(49,490)	
Net loss resulting from early retirement of debt	(1,708)	(6,776)	(1,958)	(6,776)
(Provision for) benefit from income taxes	5,583	(7,941)	(5,103)	(12,889)
Net income attributable to Arch Coal	$ 19,056	$ 46,678	$ 82,128	$ 111,038

Table of Contents

(1) Corporate and other Adjusted EBITDA includes primarily selling, general and administrative expenses, income from our equity investments, change in fair value of coal derivatives and coal trading activities, net.
(2) Includes acquisition and transition costs as reflected on the condensed consolidated statements of income and the pre-tax impact on cost of sales of inventory written up to fair value in the ICG acquisition. Adjustments made to the provisional fair value of inventories during the third quarter of 2011 are reflected in the accompanying results assuming the adjustments were made as of the ICG acquisition date.

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.

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

In June 2011, we issued equity and debt securities to finance the ICG acquisition. On June 8, 2011, we sold 48 million shares of our common stock at a public offering price of $27.00 per share pursuant to an automatically effective shelf registration statement on Form S-3, a prospectus previously filed and a related prospectus supplement filed in June 2011. On July 8, 2011, we issued an additional 0.7 million shares of our common stock under the same terms and conditions to cover underwriters over-allotments for net proceeds of $18.4 million. On June 14, 2011, we issued $1.0 billion in aggregate principal amount of 7.0% senior unsecured notes due in 2019 at par and $1.0 billion in aggregate principal amount of 7.25% senior unsecured notes due in 2021 at par. We secured bridge financing to ensure that funds would be available to us, if needed, to close the transaction. While we did not draw on the line of credit, we incurred bridge financing costs of $49.9 million related to the bridge financing.

Our indebtedness consisted of the following:

	September 30, 2011	December 31, 2010
	(In thousands)	
Commercial paper	$	$ 56,904
Indebtedness to banks under credit facilities	340,000	
6.75% senior notes ($450.0 million face value) due July 1, 2013	451,132	451,618
8.75% senior notes ($600.0 million face value) due August 1, 2016	588,496	587,126
7.00% senior notes due June 15, 2019 at par	1,000,000	

7.25% senior notes due October 1, 2020 at par		500,000		500,000
7.25% senior notes due June 15, 2021 at par		1,000,000		
Other		8,858		14,093
		3,888,486		1,609,741
Less current maturities of debt and short-term borrowings		47,156		70,997
Long-term debt	$	3,841,330	$	1,538,744

2019 and 2021 Senior Notes

Interest is payable on the 2019 Notes and 2021 Notes on June 15 and December 15 of each year, commencing December 15, 2011. At any time prior to June 15, 2014, we may redeem up to 35% of the aggregate principal amount of each of the 2019 Notes

Table of Contents

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

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

We entered into a registration rights agreement (the Registration Rights Agreement) in connection with the issuance and sale of the 2019 Notes and 2021 Notes. Pursuant to the Registration Rights Agreement, we agreed to file a registration statement with the Securities and Exchange Commission to register an exchange offer pursuant to which the Company will offer to exchange a like aggregate principal amount of senior notes identical in all material respects to the 2019 Notes and 2021 Notes, except for terms relating to additional interest and transfer restrictions, for any or all of the outstanding 2019 Notes and 2021 Notes. Pursuant to the Registration Rights Agreement, we must use commercially reasonable efforts to cause the registration statement to become effective as soon as practicable and to complete the exchange offer no later than June 13, 2012. Should we fail to meet these obligations within the specified time frame, the applicable interest rates on the 2019 Notes and the 2021 Notes shall be increased by one-quarter of one percent per annum for the first 90 days following the occurrence of such failure. Such interest rates will increase by an additional one-quarter of one percent per annum thereafter at the end of each subsequent 90- day period up to a maximum aggregate increase of one percent per annum. Once any of the required events occur, the interest rates will revert to the rate specified in the indenture governing the 2019 Notes and 2021 Notes.

ICG Debt

Upon the closing of the acquisition, we gave our 30-day redemption notice to the Trustee of ICG s 9.125% senior notes and legally discharged our obligation under the 9.125% senior notes by depositing $260.7 million with the Trustee to redeem the debt. On July 14, 2011, all of the outstanding 9.125% senior notes were redeemed at an aggregate price of $251.4 million, including the required make-whole premium, plus accrued interest of $5.2 million, and the remainder of the deposit was returned to us.

At the acquisition date, ICG s 4.00% convertible senior notes with a fair value of $298.5 million and 9.00% convertible senior notes with a fair value of $1.7 million (convertible notes) became convertible into cash, pursuant to the amended indentures governing the convertible notes, at a calculated conversion rate of $2,614.6848 for each $1,000 in principal amount surrendered for conversion for the 4.00% convertible notes and $2,392.73414 for the 9.00% convertible notes for conversions occurring prior to August 17, 2011.

Other ICG debt, with a fair value of approximately $54.0 million at the acquisition date, consisted mainly of equipment notes and insurance notes payable.

We recognized net losses of $1.7 million and $2.0 million during the three and nine months ended September 30, 2011, respectively, on the early extinguishment of ICG s debt, including the conversions of the 4.00% and 9.00% convertible notes described above. The remaining amounts outstanding of under the convertible notes and other ICG debt is included in other in the debt table above.

Credit Facilities

On June 14, 2011, we amended and restated our secured credit facility to allow for up to $2.0 billion in borrowings. Borrowings under this credit facility bear interest at a floating rate based on a LIBOR determined by reference to our leverage ratio, as calculated in accordance with the credit agreement. The credit facility has a five-year term that expires on June 14, 2016 and is secured by substantially all of our assets as well as our ownership interests in substantially all of our subsidiaries, excluding our ownership interests in Arch Western and its subsidiaries. Commitment fees of 0.50% per annum are payable on the average unused daily balance of the revolving credit facility. We paid and deferred $20.7 million in financing fees related to the amendment of this agreement.

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

Table of Contents

Availability

As of September 30, 2011 we had $300.0 million of borrowings outstanding under the amended and restated secured credit facility and $40.0 million of borrowings outstanding under our accounts receivable securitization program. As of September 30, 2011, we had availability of approximately $1.0 billion under all lines of credit, as limited by customary financial covenants that may limit our total debt based on defined earnings measurements. We also had outstanding letters of credit of $141 million as of September 30, 2011.

We have filed a universal shelf registration statement on Form S-3 with the SEC that allows us to offer and sell from time to time an unlimited amount of unsecured debt securities consisting of notes, debentures and other debt securities, common stock, preferred stock, warrants and/or units. Related proceeds could be used for general corporate purposes, including repayment of other debt, capital expenditures, possible acquisitions and any other purposes that may be stated in any related prospectus supplement.

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

	Nine Months Ended September 30, 2011	2010
	(Dollars in thousands)	
Cash provided by (used in):		
Operating activities	$ 471,367	$ 456,680
Investing activities	(3,174,006)	(261,786)
Financing activities	2,767,555	(192,279)

Cash provided by operating activities increased in the first nine months of 2011 compared to the first nine months of 2010. The increase is primarily due to higher operating income, partially offset by a build in coal inventories.

We used approximately $2.9 billion more cash in investing activities in the first nine months of 2011 compared to the amount used in the first nine months of 2010, due to the acquisition of ICG. These transactions are discussed previously in this section.

Cash provided by financing activities was $2.8 billion in the first nine months of 2011, compared to the cash used in financing activities during the first nine months of 2010 of $192.3 million. The change is a result of the proceeds from ICG acquisition financing transactions. We paid financing costs of $114.6 million in conjunction with these transactions. We also paid dividends of $57.5 million in the nine months ended September 30, 2011 and $47.1 million in the nine months ended September 30, 2010.

Ratio of Earnings to Fixed Charges

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

	Nine Months Ended September 30	
	2011	2010
Ratio of earnings to combined fixed charges and preference dividends	1.45x	2.10x

Critical Accounting Policies

For a description of our critical accounting policies, see Critical Accounting Policies under Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2010. There have been no significant changes to our critical accounting policies during the three months ended September 30, 2011.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We manage our commodity price risk for our non-trading, long-term coal contract portfolio through the use of long-term coal supply agreements, and to a limited extent, through the use of derivative instruments. Our commitments for the full year 2011, 2012 and 2013 are as follows:

Table of Contents

	2011			2012			2013		
	Tons		Price	Tons		Price	Tons		Price
Powder River Basin									
Committed, Priced	117.5	$	13.60	93.3	$	14.49	42.7	$	14.91
Committed, Unpriced	0.5			8.4			11.5		