

ARCH COAL INC
Form 10-Q
May 12, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

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

For the transition period from to .

Commission file number: 1-13105

Arch Coal, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

43-0921172
(I.R.S. Employer
Identification Number)

One CityPlace Drive, Suite 300, St. Louis, Missouri
(Address of principal executive offices)

63141
(Zip code)

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

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

Edgar Filing: ARCH COAL INC - Form 10-Q

At April 30, 2014 there were 212,279,999 shares of the registrant's common stock outstanding.

Table of Contents

TABLE OF CONTENTS

| | Page |
|--|-------------|
| <u>Part I FINANCIAL INFORMATION</u> | 3 |
| <u>Item 1. Financial Statements</u> | 3 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 24 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | 29 |
| <u>Item 4. Controls and Procedures</u> | 30 |
| <u>Part II OTHER INFORMATION</u> | |
| <u>Item 1. Legal Proceedings</u> | 31 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 34 |
| <u>Item 4. Mine Safety Disclosures</u> | 34 |
| <u>Item 6. Exhibits</u> | 35 |

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

| | Three Months Ended March 31, | |
|---|-------------------------------------|-------------|
| | 2014 | 2013 |
| | (Unaudited) | |
| Revenues | \$ 735,971 | \$ 737,370 |
| Costs, expenses and other operating | | |
| Cost of sales (exclusive of items shown separately below) | 686,314 | 649,743 |
| Depreciation, depletion and amortization | 104,423 | 110,193 |
| Amortization of acquired sales contracts, net | (3,696) | (2,810) |
| Change in fair value of coal derivatives and coal trading activities, net | 914 | 1,308 |
| Selling, general and administrative expenses | 29,136 | 33,209 |
| Other operating income, net | (7,998) | (2,842) |
| | 809,093 | 788,801 |
| Loss from operations | (73,122) | (51,431) |
| Interest expense, net | | |
| Interest expense | (96,471) | (95,074) |
| Interest and investment income | 1,843 | 2,836 |
| | (94,628) | (92,238) |
| Loss from continuing operations before income taxes | (167,750) | (143,669) |
| Benefit from income taxes | (43,611) | (59,353) |
| Loss from continuing operations | (124,139) | (84,316) |
| Income from discontinued operations, net of tax | | 14,267 |
| Net loss | \$ (124,139) | \$ (70,049) |
| Loss from continuing operations | | |
| Basic and diluted loss per common share | \$ (0.59) | \$ (0.40) |
| Net loss | | |
| Basic and diluted loss per common share | \$ (0.59) | \$ (0.33) |
| Basic and diluted weighted average shares outstanding | 212,171 | 212,062 |
| Dividends declared per common share | \$ 0.01 | \$ 0.03 |

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

Table of Contents**Arch Coal, Inc. and Subsidiaries****Condensed Consolidated Statements of Comprehensive Income (Loss)****(in thousands)**

| | Three Months Ended March 31, | |
|--|-------------------------------------|-------------|
| | 2014 | 2013 |
| Net loss | \$ (124,139) | \$ (70,049) |
| Derivative instruments | | |
| Comprehensive loss before tax | (229) | (1,179) |
| Income tax benefit | 82 | 425 |
| | (147) | (754) |
| Pension, postretirement and other post-employment benefits | | |
| Comprehensive income (loss) before tax | (1,847) | 1,954 |
| Income tax benefit (provision) | 665 | (703) |
| | (1,182) | 1,251 |
| Available-for-sale securities | | |
| Comprehensive income (loss) before tax | (2,033) | 1,553 |
| Income tax benefit (provision) | 732 | (559) |
| | (1,301) | 994 |
| Total other comprehensive income (loss) | (2,630) | 1,491 |
| Total comprehensive loss | \$ (126,769) | \$ (68,558) |

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)

| | March 31, 2014 | December 31, 2013 |
|--|-------------------|----------------------|
| | (Unaudited) | |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 865,761 | \$ 911,099 |
| Short term investments | 248,572 | 248,414 |
| Trade accounts receivable | 230,002 | 198,020 |
| Other receivables | 44,810 | 31,553 |
| Inventories | 224,806 | 264,161 |
| Prepaid royalties | 6,896 | 8,083 |
| Deferred income taxes | 48,869 | 49,144 |
| Coal derivative assets | 12,316 | 14,851 |
| Other current assets | 55,296 | 56,746 |
| Total current assets | 1,737,328 | 1,782,071 |
| Property, plant and equipment, net | 6,616,144 | 6,734,286 |
| Other assets | | |
| Prepaid royalties | 87,552 | 87,577 |
| Equity investments | 223,235 | 221,456 |
| Other noncurrent assets | 158,925 | 164,803 |
| Total other assets | 469,712 | 473,836 |
| Total assets | \$ 8,823,184 | \$ 8,990,193 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Accounts payable | \$ 160,361 | \$ 176,142 |
| Accrued expenses and other current liabilities | 328,561 | 278,587 |
| Current maturities of debt | 29,950 | 33,493 |
| Total current liabilities | 518,872 | 488,222 |
| Long-term debt | 5,112,995 | 5,118,002 |
| Asset retirement obligations | 390,408 | 402,713 |
| Accrued pension benefits | 10,484 | 7,111 |
| Accrued postretirement benefits other than pension | 37,995 | 39,255 |
| Accrued workers' compensation | 75,817 | 78,062 |
| Deferred income taxes | 368,057 | 413,546 |
| Other noncurrent liabilities | 181,866 | 190,033 |
| Total liabilities | 6,696,494 | 6,736,944 |
| Stockholders' equity | | |
| Common stock, \$0.01 par value, authorized 260,000 shares, issued 213,792 shares at both March 31, 2014 and December 31, 2013. | 2,141 | 2,141 |
| Paid-in capital | 3,040,946 | 3,038,613 |
| Treasury stock, at cost | (53,848) | (53,848) |
| Accumulated deficit | (897,611) | (771,349) |
| Accumulated other comprehensive income | 35,062 | 37,692 |
| Total stockholders' equity | 2,126,690 | 2,253,249 |
| Total liabilities and stockholders' equity | \$ 8,823,184 | \$ 8,990,193 |

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)

| | Three Months Ended March 31, | |
|---|-------------------------------------|-------------|
| | 2014 | 2013 |
| | (Unaudited) | |
| Operating activities | | |
| Net loss | \$ (124,139) | \$ (70,049) |
| Adjustments to reconcile net loss to cash provided by (used in) operating activities: | | |
| Depreciation, depletion and amortization | 104,423 | 118,868 |
| Amortization of acquired sales contracts, net | (3,696) | (2,810) |
| Amortization relating to financing activities | 3,236 | 6,167 |
| Prepaid royalties expensed | 1,803 | 3,537 |
| Employee stock-based compensation expense | 2,333 | 2,713 |
| Gains on disposals and divestitures, net | (15,129) | (595) |
| Changes in: | | |
| Receivables | (27,245) | (12,340) |
| Inventories | 7,441 | (2,816) |
| Accounts payable, accrued expenses and other current liabilities | 43,989 | 38,249 |
| Income taxes, net | (115) | 458 |
| Deferred income taxes | (43,698) | (54,993) |
| Other | 10,522 | 16,902 |
| Cash provided by (used in) operating activities | (40,275) | 43,291 |
| Investing activities | | |
| Capital expenditures | (14,454) | (54,522) |
| Additions to prepaid royalties | (591) | (9,142) |
| Proceeds from disposals and divestitures | 28,195 | 714 |
| Purchases of short term investments | (119,176) | (26,787) |
| Proceeds from sales of short term investments | 117,681 | 11,534 |
| Investments in and advances to affiliates | (3,242) | (4,298) |
| Change in restricted cash | | 1,163 |
| Cash provided by (used in) investing activities | 8,413 | (81,338) |
| Financing activities | | |
| Payments on term loan | (4,875) | (4,125) |
| Net payments on other debt | (4,521) | (5,964) |
| Debt financing costs | (1,957) | |
| Dividends paid | (2,123) | (6,367) |
| Cash used in financing activities | (13,476) | (16,456) |
| Decrease in cash and cash equivalents | (45,338) | (54,503) |
| Cash and cash equivalents, beginning of period | 911,099 | 784,622 |
| Cash and cash equivalents, end of period | \$ 865,761 | \$ 730,119 |

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

Table of Contents

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

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Arch Coal, Inc. and its subsidiaries and controlled entities (the Company). The Company's primary business is the production of thermal and metallurgical coal from surface and underground mines located throughout the United States, for sale to utility, industrial and steel producers both in the United States and around the world. The Company currently operates mining complexes in West Virginia, Kentucky, Maryland, Virginia, Illinois, Wyoming and Colorado. All subsidiaries are wholly-owned. Intercompany transactions and accounts have been eliminated in consolidation.

The Company completed the sale of Canyon Fuel Company, LLC (Canyon Fuel) on August 16, 2013. The results of Canyon Fuel have been segregated from continuing operations and are reflected, net of tax, as discontinued operations in the condensed consolidated statements of operations for the three months ended March 31, 2013.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial reporting and U.S. Securities and Exchange Commission regulations. In the opinion of management, all adjustments, consisting of normal, recurring accruals considered necessary for a fair presentation, have been included. Results of operations for the three months ended March 31, 2014 are not necessarily indicative of results to be expected for the year ending December 31, 2014. 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, 2013 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission.

2. Accounting Policies

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

3. Accumulated Other Comprehensive Income

The following items are included in accumulated other comprehensive income:

Edgar Filing: ARCH COAL INC - Form 10-Q

| | Derivative Instruments | Pension, Postretirement and Other Post- Employment Benefits | Available-for- Sale Securities | Accumulated Other Comprehensive Loss |
|---|---------------------------|--|-----------------------------------|---|
| (In thousands) | | | | |
| Balance at December 31, 2013 | \$ 565 | \$ 31,112 | \$ 6,015 | \$ 37,692 |
| Unrealized gains (losses) | 47 | | (1,657) | (1,610) |
| Amounts reclassified from accumulated other comprehensive income | (194) | (1,182) | 356 | (1,020) |
| Balance at March 31, 2014 | \$ 418 | \$ 29,930 | \$ 4,714 | \$ 35,062 |

The following amounts were reclassified out of accumulated other comprehensive income:

Table of Contents

| Details about accumulated other comprehensive income components | Amount Reclassified from Accumulated other comprehensive income | | Line Item in the Condensed Consolidated Statement of Operations |
|---|---|----------------|---|
| | Three months ended March 31, 2014 | March 31, 2013 | |
| | (In thousands) | | |
| Derivative instruments | \$ 303 | \$ 859 | Revenues |
| | (109) | (309) | Benefit from income taxes |
| | \$ 194 | \$ 550 | Net of tax |
| Pension, postretirement and other post-employment benefits | | | |
| Amortization of prior service credits | \$ 2,626 | \$ 2,908 | (1) |
| Amortization of actuarial gains (losses), net | (779) | (4,862) | (1) |
| | 1,847 | (1,954) | Total before tax |
| | (665) | 703 | Benefit from income taxes |
| | \$ 1,182 | \$ (1,251) | Net of tax |
| Available-for-sale securities | \$ (556) | \$ (59) | (2) Interest and investment income |
| | 200 | 21 | Benefit from income taxes |
| | \$ (356) | \$ (38) | Net of tax |

(1) Production-related benefits and workers' compensation costs are included in inventoriable production costs.

(2) The gains and losses on sales of available-for-sale-securities are determined on a specific identification basis.

4. Divestitures

During the first quarter of 2014, the Company entered into agreements to sell an operating thermal coal complex and an idled thermal coal mine in Kentucky and the Company's ADDCAR subsidiary, which manufactures a patented highwall mining system. The sales closed during the quarter for total consideration of \$45.5 million. The Company received \$26.3 million in cash and the remaining \$19.0 million is payable \$8.0 million on June 30, 2014 and \$11.0 million on December 31, 2014. The Company recognized a net pre-tax gain of \$13.8 million from these divestitures, reflected in other operating income, net in the condensed consolidated statement of operations.

The following table summarizes the assets and liabilities of the divested operations reflected in the December 31, 2013 consolidated balance sheet:

| | (In thousands) |
|---------------------------------------|----------------|
| Inventories | \$ 33,283 |
| Other current assets | 1,032 |
| Net property, plant & equipment | 104,587 |
| Other noncurrent assets | 139 |
| Accounts payable and accrued expenses | 13,005 |
| Other noncurrent liabilities | 24,276 |

Edgar Filing: ARCH COAL INC - Form 10-Q

The following table summarizes the results of Canyon Fuel, reflected as discontinued operations in the condensed consolidated statement of operations through the date of disposition:

Table of Contents

| | Three Months Ended March 31, 2013 (In thousands) | |
|--|---|--------|
| Total revenues | \$ | 88,132 |
| Income from discontinued operations before income taxes | \$ | 18,989 |
| Less: income tax expense | | 4,722 |
| Income from discontinued operations | \$ | 14,267 |
| Basic and diluted earnings per common share from discontinued operations | \$ | 0.07 |

5. Inventories

Inventories consist of the following:

| | March 31, 2014 | | December 31 2013 | |
|---------------------------|---------------------------|---------|-----------------------------|---------|
| | (In thousands) | | | |
| Coal | \$ | 98,125 | \$ | 117,531 |
| Repair parts and supplies | | 126,681 | | 137,497 |
| Work-in-process | | | | 9,133 |
| | \$ | 224,806 | \$ | 264,161 |

The repair parts and supplies are stated net of an allowance for slow-moving and obsolete inventories of \$8.6 million at March 31, 2014 and \$8.4 million at December 31, 2013.

6. Investments in Available-for-Sale Securities

The Company has invested in marketable debt securities, primarily highly liquid AA - rated corporate bonds and U.S. government and government agency securities. These investments are held in the custody of a major financial institution. These securities, along with the Company's investments in marketable equity securities, are classified as available-for-sale securities and, accordingly, the unrealized gains and losses are recorded through other comprehensive income.

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

| March 31, 2014 | | | | Balance Sheet Classification | |
|-----------------------|---------------------------------------|--|-----------------------|---|-------------------------|
| Cost Basis | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Short-Term Investments | Other Assets |
| (In thousands) | | | | | |

Edgar Filing: ARCH COAL INC - Form 10-Q

| | | | | | | | | | |
|---------------------------|----|---------|----|--------|----|---------|------------|------------|-----------|
| Available-for-sale: | | | | | | | | | |
| Corporate notes and bonds | \$ | 250,723 | \$ | 4 | \$ | (2,155) | \$ 248,572 | \$ 248,572 | \$ |
| Equity securities | | 5,420 | | 12,203 | | (2,698) | 14,925 | | 14,925 |
| Total Investments | \$ | 256,143 | \$ | 12,207 | \$ | (4,853) | \$ 263,497 | \$ 248,572 | \$ 14,925 |

December 31, 2013

| | Cost Basis | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Balance Sheet Classification | | | | |
|---------------------------------------|------------|------------------------------|-------------------------------|---------------|---------------------------------|-----------------|------------|------------|-----------|
| | | | | | Short-Term Investments | Other Assets | | | |
| (In thousands) | | | | | | | | | |
| Available-for-sale: | | | | | | | | | |
| U.S. government and agency securities | \$ | 65,002 | \$ | 11 | \$ | (75) | \$ 64,938 | \$ 64,938 | \$ |
| Corporate notes and bonds | | 184,773 | | 7 | | (1,304) | 183,476 | 183,476 | |
| Equity securities | | 5,271 | | 13,660 | | (2,902) | 16,029 | | 16,029 |
| Total Investments | \$ | 255,046 | \$ | 13,678 | \$ | (4,281) | \$ 264,443 | \$ 248,414 | \$ 16,029 |

Table of Contents

The aggregate fair value of investments with unrealized losses that have been owned for less than a year was \$200.4 million and \$164.3 million at March 31, 2014 and December 31, 2013, respectively. The aggregate fair value of investments with unrealized losses that were owned for over a year, and were also in a continuous unrealized loss position during that time, was \$34.7 million and \$48.7 million at March 31, 2014 and December 31, 2013, respectively.

The debt securities outstanding at March 31, 2014 have maturity dates ranging from the second quarter of 2014 through the third quarter of 2015. The Company classifies its investments as current based on the nature of the investments and their availability to provide cash for use in current operations.

7. Derivatives

Diesel fuel price risk management

The Company is exposed to price risk with respect to diesel fuel purchased for use in its operations. The Company anticipates purchasing approximately 57 to 67 million gallons of diesel fuel for use in its operations during 2014. To protect the Company's cash flows from increases in the price of diesel fuel for its operations, the Company uses forward physical diesel purchase contracts and purchased heating oil call options. At March 31, 2014, the Company had protected the price of approximately 87% of its expected purchases for the remainder of 2014 and 30% of its expected purchases during the first half of 2015. At March 31, 2014, the Company had purchased heating oil call options for approximately 61 million gallons for the purpose of managing the price risk associated with future diesel purchases.

The Company has also purchased heating oil call options to manage the price risk associated with fuel surcharges on its barge and rail shipments, which cover increases in diesel fuel prices for the respective carriers. At March 31, 2014, the Company held heating oil call options for 3.8 million gallons that will settle ratably in the remainder of 2014 for the purpose of managing the fluctuations in cash flows associated with fuel surcharges on future shipments.

These positions reduce the Company's risk of cash flow fluctuations related to these surcharges but the positions are not accounted for as hedges.

Coal price risk management positions

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

At March 31, 2014, the Company held derivatives for risk management purposes that are expected to settle in the following years:

Edgar Filing: ARCH COAL INC - Form 10-Q

| (Tons in thousands) | 2014 | 2015 | Total |
|---------------------|-------|-------|-------|
| Coal sales | 3,991 | 1,380 | 5,371 |
| Coal purchases | 1,778 | | 1,778 |

The Company has also entered into a nominal quantity of natural gas put options to protect the Company from decreases in natural gas prices, which could impact coal demand. These options are not accounted for as hedges.

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 \$6.6 million of gains during the remainder of 2014 and \$1.4 million of gains in 2015.

Table of Contents*Tabular derivatives disclosures*

The Company has master netting agreements with all of its counterparties which 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, and not the net position presented in the accompanying condensed consolidated balance sheets. The fair value and location of derivatives reflected in the accompanying condensed consolidated balance sheets are as follows:

| Fair Value of Derivatives (In thousands) | March 31, 2014 | | December 31, 2013 | |
|--|---------------------|-------------------------|---------------------|-------------------------|
| | Asset Derivative | Liability Derivative | Asset Derivative | Liability Derivative |
| Derivatives Designated as Hedging Instruments | | | | |
| Coal | \$ 1,101 | \$ (215) | \$ 909 | \$ (26) |
| Derivatives Not Designated as Hedging Instruments | | | | |
| Heating oil - diesel purchases | 2,683 | | 4,681 | |
| Heating oil - fuel surcharges | 152 | | 422 | |
| Coal - held for trading purposes | 75,886 | (69,944) | 55,327 | (45,763) |
| Coal - risk management | 4,543 | (1,453) | 6,342 | (1,950) |
| Natural gas | 398 | | | |
| Total | 83,662 | (69,397) | 66,772 | (47,713) |
| Total derivatives | 84,763 | (69,612) | 67,681 | (47,739) |
| Effect of counterparty netting | (69,612) | 69,612 | (47,727) | 47,727 |
| Net derivatives as classified in the balance sheets | \$ 15,151 | \$ 15,151 | \$ 19,954 | \$ (12) 19,942 |

| Net derivatives as reflected on the balance sheets | March 31, 2014 | | December 31, 2013 | |
|--|--|----------------------|-------------------|----------|
| | Heating oil | Other current assets | \$ 2,835 | \$ 5,103 |
| Coal | Coal derivative assets | 12,316 | 14,851 | |
| | Accrued expenses and other current liabilities | | (12) | |
| | | \$ 15,151 | \$ 19,942 | |

The Company had a current asset for the right to reclaim cash collateral of \$6.5 million at March 31, 2014 and \$2.2 million at December 31, 2013. 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:

Edgar Filing: ARCH COAL INC - Form 10-Q

Derivatives used in Cash Flow Hedging Relationships (in thousands)

For the Three Months Ended March 31,

| | | Gain (Loss) Recognized in Other Comprehensive Income(Effective Portion) | | Gains (Losses) Reclassified from Other Comprehensive Income into Income (Effective Portion) | |
|----------------|--------|---|----------|---|----------|
| | | 2014 | 2013 | 2014 | 2013 |
| Coal sales | (1) \$ | (515) | \$ (176) | \$ 706 | \$ 1,221 |
| Coal purchases | (2) | 589 | (182) | (404) | (362) |
| Totals | \$ | 74 | \$ (358) | \$ 302 | \$ 859 |

Table of Contents

No ineffectiveness or amounts excluded from effectiveness testing relating to the Company's cash flow hedging relationships were recognized in the results of operations in the three month periods ended March 31, 2014 and 2013.

Derivatives Not Designated as Hedging Instruments (in thousands)**For the Three Months Ended March 31,**

| | | Gain (Loss) Recognized | |
|------------------------------|--------|------------------------|------------|
| | | 2014 | 2013 |
| Coal unrealized | (3) \$ | (1,302) | \$ 1,470 |
| Coal realized | (4) \$ | 2,879 | \$ 9,217 |
| Natural gas unrealized | (3) \$ | 8 | \$ |
| Heating oil diesel purchases | (4) \$ | (2,963) | \$ (4,261) |
| Heating oil fuel surcharges | (4) \$ | (254) | \$ (565) |

Location in statement of operations:

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

The Company recognized net unrealized and realized gains of \$0.4 million during the three months ended March 31, 2014 and net unrealized and realized losses of \$2.8 million during the three months ended March 31, 2013 related to its trading portfolio, which are included in the caption "Change in fair value of coal derivatives and coal trading activities, net" in the accompanying condensed consolidated statements of operations, and are not included in the previous tables reflecting the effects of derivatives on measures of financial performance.

Based on fair values at March 31, 2014, gains on derivative contracts designated as hedge instruments in cash flow hedges of approximately \$0.9 million are expected to be reclassified from other comprehensive income into earnings during the next twelve months.

8. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

Edgar Filing: ARCH COAL INC - Form 10-Q

| | March 31, 2014 | December 31, 2013 |
|-------------------------------|-------------------|----------------------|
| | (In thousands) | |
| Payroll and employee benefits | \$ 58,220 | \$ 67,621 |
| Taxes other than income taxes | 112,406 | 114,664 |
| Interest | 79,731 | 18,528 |
| Acquired sales contracts | 14,439 | 14,373 |
| Workers compensation | 16,470 | 12,434 |
| Asset retirement obligations | 22,682 | 24,940 |
| Other | 24,613 | 26,027 |
| | \$ 328,561 | \$ 278,587 |

Table of Contents**9. Debt and Financing Arrangements**

| | March 31, 2014 | December 31, 2013 |
|---|-------------------|----------------------|
| | (In thousands) | |
| Term loan due 2018 (\$1.92 billion and \$1.93 billion face value, respectively) | \$ 1,902,731 | \$ 1,906,975 |
| 7.00% senior notes due 2019 at par | 1,000,000 | 1,000,000 |
| 9.875% senior notes due 2019 (\$375.0 million face value) | 362,573 | 362,358 |
| 8.00% senior secured notes due 2019 at par | 350,000 | 350,000 |
| 7.25% senior notes due 2020 at par | 500,000 | 500,000 |
| 7.25% senior notes due 2021 at par | 1,000,000 | 1,000,000 |
| Other | 27,641 | 32,162 |
| | 5,142,945 | 5,151,495 |
| Less current maturities of debt | 29,950 | 33,493 |
| Long-term debt | \$ 5,112,995 | \$ 5,118,002 |

At March 31, 2014, the available borrowing capacity under the Company's lines of credit was approximately \$250.1 million.

10. Income taxes

During the three months ended March 31, 2014, the Company determined it was more likely than not that a portion of the federal and state net operating losses it expects to generate in 2014 will not be realized through future taxable income, and the estimated annual effective rate includes a valuation allowance for that portion. In applying the estimated annual effective rate to earnings for the three months ended March 31, 2014, the Company increased its valuation allowance by \$21.6 million related to federal net operating losses and \$2.2 million related to state net operating losses.

11. Fair Value Measurements

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

- Level 1 is defined as observable inputs such as quoted prices in active markets for identical assets. Level 1 assets include available-for-sale equity securities, U.S. Treasury securities, and coal futures that are submitted for clearing on the New York Mercantile Exchange.
- Level 2 is defined as observable inputs other than Level 1 prices. These include quoted prices for similar assets or liabilities in an active market, quoted prices for identical assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company's level 2 assets and liabilities include U.S.

Edgar Filing: ARCH COAL INC - Form 10-Q

government agency securities and commodity contracts (coal and heating oil) with fair values derived from quoted prices in over-the-counter markets or from prices received from direct broker quotes.

- Level 3 is defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. These include the Company's commodity option contracts (coal, natural gas and heating oil) valued using modeling techniques, such as Black-Scholes, that require the use of inputs, particularly volatility, that are rarely observable. Changes in the unobservable inputs would not have a significant impact on the reported Level 3 fair values at March 31, 2014.

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:

Table of Contents

| | March 31, 2014 | | | |
|--------------------------------------|----------------|-----------|------------|----------|
| | Total | Level 1 | Level 2 | Level 3 |
| | (In thousands) | | | |
| Assets: | | | | |
| Investments in marketable securities | \$ 263,497 | \$ 14,925 | \$ 248,572 | \$ |
| Derivatives | 15,151 | 10,956 | 218 | 3,977 |
| Total assets | \$ 278,648 | \$ 25,881 | \$ 248,790 | \$ 3,977 |

The Company's contracts with 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 March 31, 2014 (In thousands) | |
|--|--|---------|
| Balance, beginning of period | \$ | 4,946 |
| Realized and unrealized losses recognized in earnings, net | | (2,925) |
| Purchases | | 1,956 |
| Ending balance | \$ | 3,977 |

Net unrealized losses of \$2.6 million were recognized during the three months ended March 31, 2014 related to level 3 financial instruments held on March 31, 2014.

Fair Value of Long-Term Debt

At March 31, 2014 and December 31, 2013, the fair value of the Company's debt, including amounts classified as current, was \$4.5 billion and \$4.6 billion, respectively. Fair values are based upon observed prices in an active market, when available, or from valuation models using market information, which fall into Level 2 in the fair value hierarchy.

12. Loss Per Common Share

The effect of options, restricted stock and restricted stock units equaling 6.9 million and 8.6 million shares of common stock were excluded from the calculation of diluted weighted average shares outstanding for the three month periods ended March 31, 2014 and 2013, respectively, because the exercise price or grant price of the securities exceeded the average market price of the Company's common stock for these periods. The weighted average share impacts of options, restricted stock and restricted stock units that were excluded from the calculation of weighted average shares due to the Company's incurring a net loss for the three months ended March 31, 2014 and 2013 were not significant.

13. Employee Benefit Plans

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

| | Three Months Ended March 31, | | | |
|---|-------------------------------------|---------|-------------|---------|
| | 2014 | | 2013 | |
| | (In thousands) | | | |
| Service cost | \$ | 5,924 | \$ | 7,700 |
| Interest cost | | 4,364 | | 3,926 |
| Expected return on plan assets | | (5,978) | | (5,806) |
| Amortization of prior service costs (credits) | | (54) | | (158) |
| Amortization of other actuarial losses | | 948 | | 4,551 |
| Net benefit cost | \$ | 5,204 | \$ | 10,213 |

Table of Contents

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

| | Three Months Ended March 31, | |
|--|------------------------------|------------|
| | 2014 | 2013 |
| | (In thousands) | |
| Service cost | \$ 444 | \$ 556 |
| Interest cost | 464 | 431 |
| Amortization of prior service credits | (2,501) | (2,750) |
| Amortization of other actuarial losses (gains) | (170) | 77 |
| Net benefit credit | \$ (1,763) | \$ (1,686) |

14. Commitments and Contingencies

The Company accrues for cost related to contingencies when a loss is probable and the amount is reasonably determinable. Disclosure of contingencies is included in the financial statements when it is at least reasonably possible that a material loss or an additional material loss in excess of amounts already accrued may be incurred.

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. The Company's counterclaim was dismissed on motion for summary judgment entered on May 11, 2010. Allegheny's claims against ICG were also dismissed by summary judgment, but the claims against Wolf Run and Hunter Ridge were not. The court conducted a non-jury trial of this matter beginning on January 10, 2011 and concluding on February 1, 2011.

Edgar Filing: ARCH COAL INC - Form 10-Q

At the trial, Allegheny presented its evidence for breach of contract and claimed that it is entitled to past and future damages in the aggregate of between \$228 million and \$377 million. Wolf Run and Hunter Ridge presented their defense of the claims, including evidence with respect to the existence of force majeure conditions and excuse under the contract and applicable law. Wolf Run and Hunter Ridge presented evidence that Allegheny's damages calculations were significantly inflated because it did not seek to determine damages as of the time of the breach and in some instances artificially assumed future nondelivery or did not take into account the apparent requirement to supply coal in the future. On May 2, 2011, the trial court entered a Memorandum and Verdict determining that Wolf Run had breached the coal supply contract and that the performance shortfall was not excused by force majeure. The trial court awarded total damages and interest in the amount of \$104.1 million, which consisted of \$13.8 million for past damages, and \$90.3 million for future damages. 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.

Table of Contents

The parties appealed the lower court's decision to the Superior Court of Pennsylvania. On August 13, 2012, the Superior Court of Pennsylvania affirmed the award of past damages, but ruled that the lower court should have calculated future damages as of the date of breach, and remanded the matter back to the lower court with instructions to recalculate that portion of the award. On November 19, 2012, Allegheny filed a Petition for Allowance of Appeal with the Supreme Court of Pennsylvania and Wolf Run and Hunter Ridge filed an Answer. On July 2, 2013, the Supreme Court of Pennsylvania denied the Petition of Allowance. As this action finalized the past damage award, Wolf Run paid \$15.6 million for the past damage amount, including interest, to Allegheny in July 2013. The future damage award is now back before the lower court, and a new trial has been scheduled to start May 13, 2014.

In addition, the Company is a party to numerous claims and lawsuits with respect to various matters. As of March 31, 2014 and December 31, 2013, the Company had accrued \$23.1 million and \$30.4 million, respectively, for all legal matters, including \$10.1 million and \$11.7 million, respectively, classified as current. The ultimate resolution of any such legal matter could result in outcomes which may be materially different from amounts the Company has accrued for such matters.

15. Segment Information

The Company's reportable business segments are based on the major coal producing basins in which the Company operates and may include a number of mine complexes. The Company manages its coal sales by coal basin, not by individual mining complex. Geology, coal transportation routes to customers, regulatory environments and coal quality or type are characteristic to a basin, and, accordingly, market and contract pricing have developed by coal basin. Mining 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; and the Appalachia (APP) segment, with operations in West Virginia, Kentucky, Maryland and Virginia. The Other category combines other operating segments and includes the Company's coal mining operations in Colorado and Illinois and its ADDCAR subsidiary, which the Company sold in the first quarter of 2014.

Operating segment results for the three months ended March 31, 2014 and 2013 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. These reportable segments results do not reflect the mine closure or impairment costs, since those are not reflected in the operating income reviewed by management. Corporate, Other and Eliminations includes these charges, as well as 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 operating segment results reflect only those from continuing operations, and exclude the results of Canyon Fuel, since they are classified as discontinued operations in the condensed consolidated statements of operations.

The asset amounts below represent an allocation of assets consistent with the basis used for the Company's incentive compensation plans. The amounts in Corporate, Other and Eliminations represent primarily corporate assets (cash, receivables, investments, plant, property and equipment) as well as unassigned coal reserves, above-market acquired sales contracts and other unassigned assets.

Table of Contents

| | PRB | APP | Other Operating Segments (In thousands) | Corporate, Other and Eliminations | Consolidated |
|--|------------|------------|--|---|--------------|
| Three Months Ended March 31, 2014 | | | | | |
| Revenues | \$ 358,607 | \$ 279,137 | \$ 98,227 | \$ | \$ 735,971 |
| Income (loss) from operations | (4,898) | (25,728) | 1,635 | (44,131) | (73,122) |
| Depreciation, depletion and amortization | 39,245 | 54,988 | 9,519 | 671 | 104,423 |
| Amortization of acquired sales contracts, net | (789) | (2,974) | 67 | | (3,696) |
| Capital expenditures | 2,094 | 8,156 | 1,801 | 2,403 | 14,454 |
| Three Months Ended March 31, 2013 | | | | | |
| Revenues | \$ 361,946 | \$ 282,618 | \$ 92,806 | \$ | \$ 737,370 |
| Income (loss) from operations | 15,516 | (27,116) | 7,384 | (47,215) | (51,431) |
| Depreciation, depletion and amortization | 42,227 | 55,331 | 11,304 | 1,331 | 110,193 |
| Amortization of acquired sales contracts, net | (1,199) | (2,472) | 861 | | (2,810) |
| Capital expenditures | 2,157 | 49,297 | 763 | 2,305 | 54,522 |

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

| | Three Months Ended March 31, | |
|---|------------------------------|--------------|
| | 2014 | 2013 |
| | (In thousands) | |
| Loss from operations | \$ (73,122) | \$ (51,431) |
| Interest expense | (96,471) | (95,074) |
| Interest and investment income | 1,843 | 2,836 |
| Loss from continuing operations before income taxes | \$ (167,750) | \$ (143,669) |

16. Supplemental Consolidating Financial Information

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

Table of Contents**Condensed Consolidating Statements of Operations****Three Months Ended March 31, 2014**

| | Parent/Issuer | Guarantor Subsidiaries | Non- Guarantor Subsidiaries (In thousands) | Eliminations | Consolidated |
|---|---------------|---------------------------|---|--------------|--------------|
| Revenues | \$ | \$ 735,971 | \$ | \$ | \$ 735,971 |
| Costs, expenses and other | | | | | |
| Cost of sales (exclusive of items shown separately below) | 3,389 | 683,775 | | (850) | 686,314 |
| Depreciation, depletion and amortization | 1,472 | 102,942 | 9 | | 104,423 |
| Amortization of acquired sales contracts, net | | (3,696) | | | (3,696) |
| Change in fair value of coal derivatives and coal trading activities, net | | 914 | | | 914 |
| Selling, general and administrative expenses | 19,944 | 7,865 | 1,803 | (476) | 29,136 |
| Other operating income, net | 1,593 | (9,480) | (1,437) | 1,326 | (7,998) |
| | 26,398 | 782,320 | 375 | | 809,093 |
| Loss from investment in subsidiaries | (35,347) | | | 35,347 | |
| Loss from operations | (61,745) | (46,349) | (375) | 35,347 | (73,122) |
| Interest expense, net | | | | | |
| Interest expense | (113,655) | (6,324) | (1,050) | 24,558 | (96,471) |
| Interest and investment income | 7,601 | 17,651 | 1,149 | (24,558) | 1,843 |
| | (106,054) | 11,327 | 99 | | (94,628) |
| Loss from continuing operations before income taxes | (167,799) | (35,022) | (276) | 35,347 | (167,750) |
| Provision for (benefit from) income taxes | (43,660) | | 49 | | (43,611) |
| Net loss | \$ (124,139) | \$ (35,022) | \$ (325) | \$ 35,347 | \$ (124,139) |
| Total comprehensive loss | \$ (126,769) | \$ (36,428) | \$ (325) | \$ 36,753 | \$ (126,769) |

Table of Contents**Condensed Consolidating Statements of Operations****Three Months Ended March 31, 2013**

| | Parent/Issuer | Guarantor Subsidiaries | Non- Guarantor Subsidiaries (In thousands) | Eliminations | Consolidated |
|---|---------------|---------------------------|---|--------------|--------------|
| Revenues | \$ | \$ 737,370 | \$ | \$ | \$ 737,370 |
| Costs, expenses and other | | | | | |
| Cost of sales (exclusive of items shown separately below) | 2,883 | 646,860 | | | 649,743 |
| Depreciation, depletion and amortization | 1,406 | 108,778 | 9 | | 110,193 |
| Amortization of acquired sales contracts, net | | (2,810) | | | (2,810) |
| Change in fair value of coal derivatives and coal trading activities, net | | 1,308 | | | 1,308 |
| Selling, general and administrative expenses | 21,698 | 10,035 | 1,476 | | 33,209 |
| Other operating income, net | (5,907) | 4,077 | (1,012) | | (2,842) |
| | 20,080 | 768,248 | 473 | | 788,801 |
| Income from investment in subsidiaries | (2,871) | | | 2,871 | |
| Income (loss) from operations | (22,951) | (30,878) | (473) | 2,871 | (51,431) |
| Interest expense, net | | | | | |
| Interest expense | (110,827) | (6,442) | (1,041) | 23,236 | (95,074) |
| Interest and investment income | 9,098 | 15,443 | 1,531 | (23,236) | 2,836 |
| | (101,729) | 9,001 | 490 | | (92,238) |
| Income (loss) from continuing operations before income taxes | (124,680) | (21,877) | 17 | 2,871 | (143,669) |
| Benefit from income taxes | (59,353) | | | | (59,353) |
| Income (loss) from continuing operations | (65,327) | (21,877) | 17 | 2,871 | (84,316) |
| Income from discontinued operations, net of tax | (4,722) | 18,989 | | | 14,267 |
| Net income (loss) | \$ (70,049) | \$ (2,888) | \$ 17 | \$ 2,871 | \$ (70,049) |
| Total comprehensive income (loss) | \$ (68,558) | \$ (3,324) | \$ 17 | \$ 3,307 | \$ (68,558) |

Table of Contents**Condensed Consolidating Balance Sheets**

March 31, 2014

| | Parent/Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (In thousands) | Eliminations | Consolidated |
|---|---------------|---------------------------|---|-----------------|--------------|
| Assets | | | | | |
| Cash and cash equivalents | \$ 753,902 | \$ 100,353 | \$ 11,506 | \$ | \$ 865,761 |
| Short term investments | 248,572 | | | | 248,572 |
| Receivables | 33,115 | 16,594 | 229,737 | (4,634) | 274,812 |
| Inventories | | 224,806 | | | 224,806 |
| Other | 80,500 | 42,347 | 530 | | 123,377 |
| Total current assets | 1,116,089 | 384,100 | 241,773 | (4,634) | 1,737,328 |
| Property, plant and equipment, net | 23,765 | 6,592,317 | 28 | 34 | 6,616,144 |
| Investment in subsidiaries | 7,724,424 | | | (7,724,424) | |
| Intercompany receivables | | 2,079,874 | | (2,079,874) | |
| Note receivable from Arch Western | 675,000 | | | (675,000) | |
| Other | 157,663 | 311,976 | 73 | | 469,712 |
| Total other assets | 8,557,087 | 2,391,850 | 73 | (10,479,298) | 469,712 |
| Total assets | \$ 9,696,941 | \$ 9,368,267 | \$ 241,874 | \$ (10,483,898) | \$ 8,823,184 |
| Liabilities and Stockholders Equity | | | | | |
| Accounts payable | \$ 18,326 | \$ 141,921 | \$ 114 | \$ | \$ 160,361 |
| Accrued expenses and other current liabilities | 105,706 | 226,757 | 732 | (4,634) | 328,561 |
| Current maturities of debt | 25,481 | 4,469 | | | 29,950 |
| Total current liabilities | 149,513 | 373,147 | 846 | (4,634) | 518,872 |
| Long-term debt | 5,095,777 | 17,218 | | | 5,112,995 |
| Intercompany payables | 1,865,706 | | 214,168 | (2,079,874) | |
| Note payable to Arch Coal | | 675,000 | | (675,000) | |
| Asset retirement obligations | 1,018 | 389,390 | | | 390,408 |
| Accrued pension benefits | 2,873 | 7,611 | | | 10,484 |
| Accrued postretirement benefits other than pension | 4,213 | 33,782 | | | 37,995 |
| Accrued workers compensation | 27,606 | 48,211 | | | 75,817 |
| Deferred income taxes | 368,057 | | | | 368,057 |
| Other noncurrent liabilities | 55,522 | 126,039 | 305 | | 181,866 |
| Total liabilities | 7,570,285 | 1,670,398 | 215,319 | (2,759,508) | 6,696,494 |
| Stockholders equity | 2,126,656 | 7,697,869 | 26,555 | (7,724,390) | 2,126,690 |
| Total liabilities and stockholders equity | \$ 9,696,941 | \$ 9,368,267 | \$ 241,874 | \$ (10,483,898) | \$ 8,823,184 |

Table of Contents**Condensed Consolidating Balance Sheets**

December 31, 2013

| | Parent/Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (In thousands) | Eliminations | Consolidated |
|---|---------------|---------------------------|---|-----------------|--------------|
| Assets | | | | | |
| Cash and cash equivalents | \$ 799,333 | \$ 100,418 | \$ 11,348 | \$ | \$ 911,099 |
| Short term investments | 248,414 | | | | 248,414 |
| Receivables | 14,177 | 23,018 | 197,015 | (4,637) | 229,573 |
| Inventories | | 264,161 | | | 264,161 |
| Other | 84,401 | 43,617 | 806 | | 128,824 |
| Total current assets | 1,146,325 | 431,214 | 209,169 | (4,637) | 1,782,071 |
| Property, plant and equipment, net | 24,851 | 6,709,398 | 37 | | 6,734,286 |
| Investment in subsidiaries | 7,741,589 | | | (7,741,589) | |
| Intercompany receivables | | 1,953,719 | (181,095) | (1,772,624) | |
| Note receivable from Arch Western | 675,000 | | | (675,000) | |
| Other | 162,287 | 311,463 | 86 | | 473,836 |
| Total other assets | 8,578,876 | 2,265,182 | (181,009) | (10,189,213) | 473,836 |
| Total assets | \$ 9,750,052 | \$ 9,405,794 | \$ 28,197 | \$ (10,193,850) | \$ 8,990,193 |
| Liabilities and Stockholders Equity | | | | | |
| Accounts payable | \$ 17,781 | \$ 158,224 | \$ 137 | \$ | \$ 176,142 |
| Accrued expenses and other current liabilities | 53,779 | 228,664 | 781 | (4,637) | 278,587 |
| Current maturities of debt | 28,882 | 4,611 | | | 33,493 |
| Total current liabilities | 100,442 | 391,499 | 918 | (4,637) | 488,222 |
| Long-term debt | 5,099,833 | 18,169 | | | 5,118,002 |
| Intercompany payables | 1,772,624 | | | (1,772,624) | |
| Note payable to Arch Coal | | 675,000 | | (675,000) | |
| Asset retirement obligations | 1,095 | 401,618 | | | 402,713 |
| Accrued pension benefits | 7,797 | (686) | | | 7,111 |
| Accrued postretirement benefits other than pension | 12,079 | 27,176 | | | 39,255 |
| Accrued workers compensation | 21,546 | 56,516 | | | 78,062 |
| Deferred income taxes | 413,546 | | | | 413,546 |
| Other noncurrent liabilities | 67,841 | 121,794 | 398 | | 190,033 |
| Total liabilities | 7,496,803 | 1,691,086 | 1,316 | (2,452,261) | 6,736,944 |
| Stockholders equity | 2,253,249 | 7,714,708 | 26,881 | (7,741,589) | 2,253,249 |
| Total liabilities and stockholders equity | \$ 9,750,052 | \$ 9,405,794 | \$ 28,197 | \$ (10,193,850) | \$ 8,990,193 |

Table of Contents**Condensed Consolidating Statements of Cash Flows****Three Months Ended March 31, 2014**

| | Parent/Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (In thousands) | Eliminations | Consolidated |
|--|----------------------|-----------------------------------|--|---------------------|---------------------|
| Cash provided by (used in) operating activities | \$ (150,338) | \$ 142,978 | \$ (32,915) | \$ | \$ (40,275) |
| Investing Activities | | | | | |
| Capital expenditures | (492) | (13,962) | | | (14,454) |
| Additions to prepaid royalties | | (591) | | | (591) |
| Proceeds from disposals and divestitures | 26,319 | 1,876 | | | 28,195 |
| Purchases of short term investments | (119,176) | | | | (119,176) |
| Proceeds from sales of short term investments | 117,681 | | | | 117,681 |
| Investments in and advances to affiliates | (1,016) | (2,226) | | | (3,242) |
| Cash provided by (used in) investing activities | 23,316 | (14,903) | | | 8,413 |
| Financing Activities | | | | | |
| Payments on term loan | (4,875) | | | | (4,875) |
| Net payments on other debt | (4,521) | | | | (4,521) |
| Debt financing costs | (1,957) | | | | (1,957) |
| Dividends paid | (2,123) | | | | (2,123) |
| Transactions with affiliates, net | 95,067 | (128,140) | 33,073 | | |
| Cash provided by (used in) financing activities | 81,591 | (128,140) | 33,073 | | (13,476) |
| Increase (decrease) in cash and cash equivalents | (45,431) | (65) | 158 | | (45,338) |
| Cash and cash equivalents, beginning of period | 799,333 | 100,418 | 11,348 | | 911,099 |
| Cash and cash equivalents, end of period | \$ 753,902 | \$ 100,353 | \$ 11,506 | \$ | \$ 865,761 |

Table of Contents

Condensed Consolidating Statements of Cash Flows

Three Months Ended March 31, 2013

| | Parent/Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|---------------|---------------------------|-------------------------------|--------------|--------------|
| Cash provided by (used in) operating activities | \$ (61,840) | \$ 120,755 | \$ (15,624) | \$ | \$ 43,291 |
| Investing Activities | | | | | |
| Capital expenditures | (615) | (53,907) | | | (54,522) |
| Additions to prepaid royalties | | (9,142) | | | (9,142) |
| Proceeds from disposals and divestitures | | 714 | | | 714 |
| Purchases of short term investments | (26,787) | | | | (26,787) |
| Proceeds from sales of short term investments | 11,534 | | | | 11,534 |
| Investments in and advances to affiliates | (2,043) | (2,383) | | 128 | (4,298) |
| Change in restricted cash | 1,163 | | | | 1,163 |
| Cash provided by (used in) investing activities | (16,748) | (64,718) | | 128 | (81,338) |
| Financing Activities | | | | | |
| Contributions from parent | | 128 | | (128) | |
| Payments on term loan | (4,125) | | | | (4,125) |
| Net payments on other debt | (5,836) | (128) | | | (5,964) |
| Dividends paid | (6,367) | | | | (6,367) |
| Transactions with affiliates, net | 20,911 | (36,076) | 15,165 | | |
| Cash provided by (used in) financing activities | 4,583 | (36,076) | 15,165 | (128) | (16,456) |
| Increase (decrease) in cash and cash equivalents | (74,005) | 19,961 | (459) | | (54,503) |
| Cash and cash equivalents, beginning of period | 671,313 | 100,468 | 12,841 | | 784,622 |
| Cash and cash equivalents, end of period | \$ 597,308 | \$ 120,429 | \$ 12,382 | \$ | \$ 730,119 |

Table of Contents

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

Overview

Our results during the first quarter of 2014, when compared to the first quarter of 2013, were impacted by the continuing weakness in coal markets, particularly for metallurgical and eastern thermal coal, and rail issues in the Powder River Basin.

Seaborne coal markets remain challenged, as oversupply continues to pressure global prices for metallurgical and thermal coals, and we expect the seaborne markets to remain weak throughout 2014. Our Leer mining complex began longwall production in December of 2013, adding high-quality metallurgical coal capacity to our Appalachian region and decreasing our regional cost structure. Due to the weak markets, we sold 1.6 million tons of metallurgical coal in the first quarter of 2014 compared to 1.7 million in the first quarter of 2013.

Power generation hit record levels in the first quarter of 2014, due to the cold winter weather throughout most of the U.S. U.S. utility coal stockpiles decreased during the winter of 2014, particularly at plants sourced from the Powder River Basin, where weather and rail service disruptions have impacted deliveries. We have witnessed improved pricing in the Powder River Basin, and new firm sales commitments in 2014 reflect higher prices than 2013. See further information regarding committed sales in Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Management has continued to focus on capital spending reductions, cost containment and efficiency efforts, and working capital and liquidity management to preserve liquidity and prepare the company to capitalize on opportunities when coal markets recover.

As part of our strategy to review our asset portfolio, we completed the sales of an operating thermal coal complex and an idled thermal coal mine in Kentucky, and our ADDCAR subsidiary, which manufactures a patented highwall mining system. We recognized net pre-tax gains from these sales of \$13.8 million in the first quarter of 2014.

Regional Performance

The following table shows results by operating segment for the three months ended March 31, 2014 and compares it with the information for the three months ended March 31, 2013. The other category represents the results of our other bituminous thermal operations: our West Elk mining complex in Colorado and our Viper mining complex in Illinois.

| | Three Months Ended March 31, | |
|---------------------------|-------------------------------------|-------------|
| | 2014 | 2013 |
| <i>Powder River Basin</i> | | |

Edgar Filing: ARCH COAL INC - Form 10-Q

| | | | | |
|--------------------------------------|----|---------|----|--------|
| Tons sold (in thousands) | | 25,666 | | 26,612 |
| Coal sales per ton sold | \$ | 12.73 | \$ | 12.68 |
| Cost per ton sold | \$ | 12.98 | \$ | 12.24 |
| Operating margin (loss) per ton sold | \$ | (0.25) | \$ | 0.44 |
| Adjusted EBITDA (in thousands) | \$ | 33,558 | \$ | 56,544 |
| <i>Appalachia</i> | | | | |
| Tons sold (in thousands) | | 3,589 | | 3,387 |
| Coal sales per ton sold | \$ | 67.70 | \$ | 74.76 |
| Cost per ton sold | \$ | 80.80 | \$ | 83.49 |
| Operating loss per ton sold | \$ | (13.10) | \$ | (8.73) |
| Adjusted EBITDA (in thousands) | \$ | 26,286 | \$ | 25,742 |
| <i>Other</i> | | | | |
| Tons sold (in thousands) | | 2,102 | | 1,926 |
| Coal sales per ton sold | \$ | 28.64 | \$ | 32.39 |
| Cost per ton sold | \$ | 27.17 | \$ | 29.15 |
| Operating margin per ton sold | \$ | 1.47 | \$ | 3.24 |
| Adjusted EBITDA (in thousands) | \$ | 13,195 | \$ | 19,625 |

Table of Contents

This table reflects numbers reported under a basis that differs from U.S. GAAP. See the Reconciliation of Non-GAAP measurements for explanation and reconciliation of these amounts to the nearest GAAP figures. Since other companies may calculate these per ton amounts differently, our calculation may not be comparable to similarly titled measures used by those companies.

Powder River Basin Adjusted EBITDA decreased approximately 40% in the first quarter of 2014 when compared to the first quarter of 2013 due to lower sales volumes and higher spending, primarily on repairs and maintenance. These costs were incurred in anticipation of higher sales volume levels to meet higher demand in the region, which did not materialize during the quarter due to the ongoing rail performance issues impacting the region.

Appalachia Adjusted EBITDA increased slightly in the first quarter of 2014 when compared to the first quarter of 2013 due to the gain on the sale of the operating thermal coal complex and idled thermal coal mine in Kentucky in the first quarter of 2014 (\$16.6 million) and an increase in thermal coal sales volumes, which were partially offset by the impact of lower coal pricing. Lower average coal pricing in the first quarter of 2014 when compared to the first quarter of 2013 was the result of lower thermal coal pricing and the weak metallurgical coal markets, which led to a decrease in metallurgical coal sales. While thermal coal pricing was lower than in the prior year, it was slightly improved over the pricing in the fourth quarter of 2013. The startup of the longwall at the Leer mining complex and lower depreciation, depletion and amortization costs contributed to lower per-ton costs in the first quarter of 2014.

Other Operating margin per ton and Adjusted EBITDA decreased in the first quarter of 2014 when compared to the first quarter of 2013 due to a decrease in export pricing and the roll-off of long-term contracts, which resulted in a decrease in per-ton realizations. Lower per-ton pricing was partially offset by an improvement in per-ton costs, the result of higher sales volumes.

Results of Operations

Three Months Ended March 31, 2014 Compared to Three Months Ended March 31, 2013

Revenues. Our revenues consist of coal sales and revenues from our ADDCAR subsidiary prior to its disposal.

Coal sales. The following table summarizes information about our coal sales during the three months ended March 31, 2014 and compares it with the information for the three months ended March 31, 2013:

| | Three Months Ended March 31, | | |
|------------|------------------------------|------------|------------|
| | 2014 | 2013 | Decrease |
| | (In thousands) | | |
| Coal sales | \$ 734,033 | \$ 736,486 | \$ (2,453) |
| Tons sold | 31,357 | 31,925 | (568) |

Edgar Filing: ARCH COAL INC - Form 10-Q

Coal sales remained relatively flat in the first quarter of 2014 from the first quarter of 2013 on a consolidated basis, as the impact of lower sales volumes (a decrease of approximately \$13 million) was partially offset by the impact of higher average per-ton pricing (an increase of approximately \$11 million). Due to the impact of changes in the regional mix, average pricing increased from \$23.07 to \$23.41 per ton, despite decreases in regional pricing, as sales volumes increased in regions with higher pricing. See discussion in *Regional Performance* for further information about regional result.

Costs, expenses and other. The following table summarizes costs, expenses and other components of operating income for the three months ended March 31, 2014 and compares it with the information for the three months ended March 31, 2013:

Edgar Filing: ARCH COAL INC - Form 10-Q

Table of Contents

| | Three Months Ended March 31, | | (Increase) Decrease |
|---|-------------------------------------|-------------|----------------------------|
| | 2014 | 2013 | in Net Loss |
| | (In thousands) | | |
| Cost of sales (exclusive of items shown separately below) | \$ 686,314 | \$ 649,743 | \$ (36,571) |
| Depreciation, depletion and amortization | 104,423 | 110,193 | 5,770 |
| Amortization of acquired sales contracts, net | (3,696) | (2,810) | 886 |
| Change in fair value of coal derivatives and coal trading activities, net | 914 | 1,308 | 394 |
| Selling, general and administrative expenses | 29,136 | 33,209 | 4,073 |
| Other operating income, net | (7,998) | (2,842) | 5,156 |
| Total costs, expenses and other | \$ 809,093 | \$ 788,801 | \$ (20,292) |

Cost of sales. Our cost of sales increased in the first quarter of 2014 from the first quarter of 2013, primarily due to an increase in sales volumes from the Appalachia region and increased spending in the Powder River Basin, which resulted in higher average per-ton costs. Higher costs resulted in an increase in cost of sales of approximately \$34 million. In addition, transportation costs increased approximately \$14 million in the first quarter of 2014 from the first quarter of 2013, primarily due to increased barge traffic. The impact of lower sales volumes partially offset the impact of higher costs (a decrease of approximately \$10 million). See discussion in *Regional Performance* for further information about regional results.

Depreciation, depletion and amortization. When compared with the first quarter of 2013, depreciation, depletion and amortization costs decreased in 2014 primarily due to the lower production levels in the Powder River Basin and ongoing reductions in capital spending.

Selling, general and administrative expenses. Total selling, general and administrative expenses decreased when compared with the first quarter of 2013, due generally to decreases in legal and professional fees (\$2.0 million), and other decreases in discretionary spending.

Other operating income, net. When compared with the first quarter of 2013, other operating income, net increased during the first quarter of 2014, primarily due to the divestitures of mining operations in the Appalachia region and our ADDCAR subsidiary discussed previously, which, when combined with other asset sales, resulted in an increase in gains of \$14.5 million. In addition, unrealized losses on derivatives in our diesel purchase risk management program decreased \$2.8 million. These factors were partially offset by a decrease in settlement gains of \$6.3 million on derivatives used to manage coal price risk, a decrease in other commercial income of \$3.2 million, and an increase of \$2.1 million to \$12.5 million of costs related to export shortfalls under throughput arrangements.

Benefit from income taxes. The following table summarizes our benefit from income taxes for the three months ended March 31, 2014 and compares it with the information for the three months ended March 31, 2013:

| | Three Months Ended March 31, | | Increase |
|---------------------------|-------------------------------------|-------------|--------------------|
| | 2014 | 2013 | in Net Loss |
| | (In thousands) | | |
| Benefit from income taxes | \$ (43,611) | \$ (59,353) | \$ (15,742) |

The income tax benefit rate of 26% in the first quarter of 2014 decreased from 41% in the first quarter of 2013 due to the establishment of a valuation allowance totaling \$23.8 million relating to 2014 federal and state net operating loss carryforwards.

Edgar Filing: ARCH COAL INC - Form 10-Q

Income from discontinued operations, net of tax The results of our Canyon Fuel subsidiary prior to its disposal are segregated from continuing operations. See further information in Note 4 to the condensed consolidated financial statements.

| | Three Months Ended March 31, | | Increase |
|---|-------------------------------------|-------------|--------------------|
| | 2014 | 2013 | in Net Loss |
| | (In thousands) | | |
| Income from discontinued operations, net of tax | \$ | \$ 14,267 | \$ (14,267) |

Table of Contents**Reconciliation of NON-GAAP measures***Segment coal sales per ton sold*

Segment coal sales per ton sold are calculated as the segment's coal sales revenues divided by segment tons sold. The segment's sales per tons sold are adjusted for transportation costs, and may be adjusted for other items that, due to accounting rules, are classified in other income on the statement of operations, but relate to price protection on the sale of coal. Segment sales per ton sold is not a measure of financial performance in accordance with generally accepted accounting principles. We believe segment sales per ton sold better reflects our revenue for the quality of coal sold and our operating results by including all income from coal sales. The adjustments made to arrive at these measures are significant in understanding and assessing our financial condition. Therefore, segment coal sales revenues should not be considered in isolation, nor as an alternative to coal sales revenues under generally accepted accounting principles.

| | Three Months Ended March 31, | |
|--|-------------------------------------|-------------|
| | 2014 | 2013 |
| | (In thousands) | |
| Reported segment coal sales revenues | \$ 629,953 | \$ 652,887 |
| Coal risk management derivative settlements classified in other income | (2,879) | (9,217) |
| Transportation costs | 106,959 | 92,816 |
| Coal sales | \$ 734,033 | \$ 736,486 |

Segment cost per ton sold

Segment costs per ton sold are calculated as the segment's cost of tons sold divided by segment tons sold. The segment's cost of tons sold are adjusted for transportation costs, and may be adjusted for other items that, due to accounting rules, are classified in other income on the statement of operations, but relate directly to the costs incurred to produce coal. Segment cost of tons sold is not a measure of financial performance in accordance with generally accepted accounting principles. We believe segment cost of tons sold better reflects our controllable costs and our operating results by including all costs incurred to produce coal. The adjustments made to arrive at these measures are significant in understanding and assessing our financial condition. Therefore, segment cost of tons sold should not be considered in isolation, nor as an alternative to cost of sales under generally accepted accounting principles.

| | Three Months Ended March 31, | |
|--|-------------------------------------|-------------|
| | 2014 | 2013 |
| | (In thousands) | |
| Reported segment cost of tons sold | \$ 680,296 | \$ 664,677 |
| Diesel fuel risk management derivative settlements classified in other income | (1,879) | (4,662) |
| Transportation costs | 106,959 | 92,816 |
| Depreciation, depletion and amortization in reported segment cost of tons sold presented on separate line on statement of operations | (103,751) | (108,435) |
| Other (other operating segments, operating overhead, etc.) | 4,689 | 5,347 |
| Cost of sales | \$ 686,314 | \$ 649,743 |

Segment Adjusted EBITDA to Net Income

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

Table of Contents

| | Three Months Ended March 31, | |
|--|-------------------------------------|-------------|
| | 2014 | 2013 |
| | (In thousands) | |
| Reported Segment Adjusted EBITDA | \$ 73,039 | \$ 101,911 |
| EBITDA from discontinued operations | | 27,677 |
| Corporate and other (1) | (45,434) | (45,959) |
| Adjusted EBITDA | 27,605 | 83,629 |
| Income tax benefit | 43,611 | 59,353 |
| Interest expense, net | (94,628) | (92,238) |
| Depreciation, depletion and amortization | (104,423) | (110,193) |
| Amortization of acquired sales contracts, net | 3,696 | 2,810 |
| Interest, depreciation, depletion and amortization classified as discontinued operations | | (13,410) |
| Net loss | \$ (124,139) | \$ (70,049) |

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

Liquidity and Capital Resources

Our primary sources of cash are coal sales to customers, availability under our credit facilities and other financing arrangements, and debt and equity offerings related to significant transactions or refinancing activity. Excluding significant investing activity, we generally satisfy our working capital requirements and fund capital expenditures and debt-service obligations with cash generated from operations, cash on hand or borrowings under our lines of credit. Such plans are subject to change based on our cash needs. Availability under our sources of liquidity, including cash and short-term investments, totaled \$1.4 billion at March 31, 2014. During the market down cycle our focus is preserving availability under credit agreements and prudently managing costs, particularly capital expenditures.

We have no meaningful maturities of debt until 2018 and no major financial maintenance covenants until June 2015, when a senior secured leverage ratio covenant goes into effect. Until then, only a minimum liquidity covenant of \$550 million remains in place. We have no borrowings outstanding under our revolving credit agreement at March 31, 2014.

The following is a summary of cash provided by or used in each of the indicated types of activities during the three months ended March 31, 2014 and 2013:

| | Three Months Ended March 31, | |
|-----------------------------|-------------------------------------|-------------|
| | 2014 | 2013 |
| | (In thousands) | |
| Cash provided by (used in): | | |
| Operating activities | \$ (40,275) | \$ 43,291 |
| Investing activities | 8,413 | (81,338) |
| Financing activities | (13,476) | (16,456) |

Edgar Filing: ARCH COAL INC - Form 10-Q

We used cash in operating activities during the first quarter of 2014 compared to generating cash from operations in the first quarter of 2013, driven by the decrease in our operating profitability resulting from weak coal market conditions and shipping issues in the Powder River Basin.

We generated cash from investing activities of \$8.4 million in the first quarter of 2014 compared to cash used in investing activities of \$81.3 million in the first quarter of 2013. Capital expenditures and additions to prepaid royalties decreased approximately \$40.1 million and \$8.6 million, respectively, during the three months ended March 31, 2014 when compared with the three months ended March 31, 2013. Cash conservation efforts and the start up of the Leer mining complex longwall in the first quarter of 2014 were responsible for the decrease in capital expenditures. The divestitures of a Kentucky operation and idled assets and our ADDCAR subsidiary resulted in an increase of \$27.5 million in proceeds from the asset sales and divestitures. We will receive additional consideration of \$19 million by the end of 2014 relating to the ADDCAR divestiture. Compared with the three months ended March 31, 2013, we invested net \$13.8 million less in short term investments in the three months ended March 31, 2014.

Table of Contents

Cash used in financing activities was approximately \$3 million less in the three months ended March 31, 2014, primarily due to the decrease in the dividend rate. The decrease in the dividend rate in the first quarter of 2014 from \$0.03 to \$0.01 reduced dividends paid from \$6.4 million during the three months ended March 31, 2013 to \$2.1 million during the three months ended March 31, 2014.

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:

| | Three Months Ended March 31, | |
|---|------------------------------|--------|
| | 2014 | 2013 |
| Ratio of earnings to combined fixed charges and preference dividends(1) | N/A | N/A(2) |

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

(2) Total losses for the ratio calculation were \$65.8 million and total fixed charges were \$99.3 million for the three months ended March 31, 2014. Total losses for the ratio calculation were \$46.9 million and total fixed charges were \$101.6 million for the three months ended March 31, 2013.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

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

Our sales commitments were as follows as of April 22, 2014:

| | 2014 | | 2015 | |
|----------------------------------|-----------------------|------------|-----------------------|------------|
| | Tons (in millions) | \$ per ton | Tons (in millions) | \$ per ton |
| <u>Powder River Basin</u> | | | | |
| Committed, Priced | 102.0 | \$ 13.08 | 57.8 | \$ 13.76 |
| Committed, Unpriced | 5.8 | | 8.6 | |
| <u>Appalachia</u> | | | | |

Edgar Filing: ARCH COAL INC - Form 10-Q

| | | | | | | |
|-----------------------------------|-----|----|-------|-----|----|-------|
| Committed, Priced Thermal | 6.0 | \$ | 56.88 | 2.6 | \$ | 55.34 |
| Committed, Unpriced Thermal | 0.2 | | | | | |
| Committed, Priced Metallurgical | 5.0 | \$ | 83.50 | 1.6 | \$ | 85.68 |
| Committed, Unpriced Metallurgical | 0.5 | | | 0.2 | | |
| Other Bituminous | | | | | | |
| Committed, Priced | 6.2 | \$ | 31.90 | 2.5 | \$ | 38.95 |
| Committed, Unpriced | 0.2 | | | | | |

We are also exposed to commodity price risk in our coal trading activities, which represents the potential future loss that could be caused by an adverse change in the market value of coal. Our coal trading portfolio included forward, swap and put and call option contracts at March 31, 2014. The estimated future realization of the value of the trading portfolio is \$6.6 million of gains in the remainder of 2014 and \$1.4 million of gains in 2015.

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

Edgar Filing: ARCH COAL INC - Form 10-Q

Table of Contents

VaR is a statistical one-tail confidence interval and down side risk estimate that relies on recent history to estimate how the value of the portfolio of positions will change if markets behave in the same way as they have in the recent past. The level of confidence is 95%. The time across which these possible value changes are being estimated is through the end of the next business day. A closed-form delta-neutral method used throughout the finance and energy sectors is employed to calculate this VaR. VaR is back tested to verify its usefulness.

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

While presenting VaR will provide a similar framework for discussing risk across companies, VaR estimates from two independent sources are rarely calculated in the same way. Without a thorough understanding of how each VaR model was calculated, it would be difficult to compare two different VaR calculations from different sources.

During the three months ended March 31, 2014, VaR for our coal trading positions that are recorded at fair value through earnings ranged from under \$0.1 million to \$0.4 million. The linear mean of each daily VaR was \$0.2 million. The final VaR at March 31, 2014 was \$0.1 million.

We are exposed to fluctuations in the fair value of coal derivatives that we enter into to manage the price risk related to future coal sales, but for which we do not elect hedge accounting. Any gains or losses on these derivative instruments would be offset in the pricing of the physical coal sale. During the three months ended March 31, 2014 VaR for our risk management positions that are recorded at fair value through earnings ranged from \$0.2 million to \$0.5 million. The linear mean of each daily VaR was \$0.3 million. The final VaR at March 31, 2014 was \$0.2 million.

We are also exposed to the risk of fluctuations in cash flows related to our purchase of diesel fuel. We expect to use approximately 57 to 67 million gallons of diesel fuel for use in our operations during 2014. We enter into forward physical purchase contracts, as well as purchased heating oil options, to reduce volatility in the price of diesel fuel for our operations. At March 31, 2014, we had protected the price of approximately 87% of our expected purchases for the remainder of 2014 and 30% of our purchases in the first half of 2015. At March 31, 2014, we had purchased heating oil call options for approximately 61 million gallons for the purpose of managing the price risk associated with future diesel purchases. We also purchase heating oil call options to manage the price risk associated with fuel surcharges on barge and rail shipments, which cover increases in diesel fuel prices. At March 31, 2014, we held purchased call options for approximately 3.8 million gallons for the purpose of managing the fluctuations in cash flows associated with fuel surcharges on future shipments. These positions reduce our risk of cash flow fluctuations related to these surcharges but the positions are not accounted for as hedges. A \$0.25 per gallon decrease in the price of heating oil would not result in an increase in our expense related to the heating oil derivatives.

We are exposed to market risk associated with interest rates due to our existing level of indebtedness. At March 31, 2014, of our \$5.1 billion principal amount of debt outstanding, approximately \$1.9 billion of outstanding borrowings have interest rates that fluctuate based on changes in the market rates. An increase in the interest rates related to these borrowings of 25 basis points would not result in an annualized increase in interest expense based on interest rates in effect at March 31, 2014, because our term loan has a minimum interest rate that exceeds the current market rates.

Item 4. Controls and Procedures.

We performed an evaluation under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2014. Based on that evaluation, our management, including our chief executive officer and chief financial officer, concluded that the disclosure controls and procedures were effective as of such date. There were no changes in our internal control over financial reporting during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II

OTHER INFORMATION

Item 1. Legal Proceedings.

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

Permit Litigation Matters

Surface mines at our Mingo Logan and Coal-Mac mining operations were identified in an existing lawsuit brought by the Ohio Valley Environmental Coalition (OVEC) in the U.S. District Court for the Southern District of West Virginia as having been granted Clean Water Act § 404 permits by the Army Corps of Engineers (Corps), allegedly in violation of the Clean Water Act and the National Environmental Policy Act. The lawsuit, brought by OVEC in September 2005, originally was filed against the Corps for permits it had issued to four subsidiaries of a company unrelated to us or our operating subsidiaries. The suit claimed that the Corps had issued permits to the subsidiaries of the unrelated company that did not comply with the National Environmental Policy Act and violated the Clean Water Act.

The court ruled on the claims associated with those four permits in orders of March 23 and June 13, 2007. In the first of those orders, the court rescinded the four permits, finding that the Corps had inadequately assessed the likely impact of valley fills on headwater streams and had relied on inadequate or unproven mitigation to offset those impacts. In the second order, the court entered a declaratory judgment that discharges of sediment from the valley fills into sediment control ponds constructed in-stream to control that sediment must themselves be permitted under a different provision of the Clean Water Act, § 402, and meet the effluent limits imposed on discharges from these ponds. Both of the district court rulings were appealed to the U.S. Court of Appeals for the Fourth Circuit.

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

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

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

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

On October 15, 2010, the United States moved to extend the existing stay for an additional 120 days (until February 22, 2011) while the EPA Administrator reviewed the Recommended Determination issued by the EPA Region 3. By Memorandum Opinion and Order dated November 2, 2010, the court granted the United States' motion. On January 13, 2011, the EPA issued its Final Determination to withdraw the specification of two of the three watersheds as a disposal site for dredged or fill material approved under the current Section 404 permit. The court was notified of the Final Determination and by order dated March 21, 2011 stayed further proceedings in the case until further order of the court, in light of the challenge to the EPA's Final Determination then pending in federal court in Washington, DC.

Table of Contents

In a Memorandum and Opinion and separate Order, each dated March 23, 2012, the federal court granted Mingo Logan's motion for summary judgment, vacated EPA's Final Determination and found valid and in full force Mingo Logan's Section 404 permit. As described more fully below, EPA appealed that order to the United States Court of Appeals for the DC circuit and by Opinion of the Court dated April 23, 2013, the court reversed the lower court's order and remanded the matter to the district court for further proceedings.

On April 5, 2012, Mingo Logan moved to lift the stay referenced above. On June 5, 2012, the Court entered an order lifting the stay and allowing the case to proceed on Mingo Logan's Motion for Summary Judgment. Shortly thereafter, OVEC filed a motion for leave to file a seventh amended and supplemental complaint seeking to update existing counts and raising two new claims (one, to enforce EPA's Final Determination and, the other, that the Corps' refusal to prepare a Supplemental Environmental Impact Statement violates the APA and NEPA). By Memorandum, Opinion and Order dated July 25, 2012, the Court granted OVEC's motion and directed the Clerk to file OVEC's Seventh Amended and Supplemental Complaint. Mingo Logan filed its Motion for Summary Judgment on August 31, 2012, along with its Answer to the Seventh Amended and Supplemental Complaint and the matter remains pending before the Court.

EPA Actions Related to Water Discharges from the Spruce Permit

By letter of September 3, 2009, the EPA asked the Corps of Engineers to suspend, revoke or modify the existing permit it issued in January 2007 to Mingo Logan under Section 404 of the Clean Water Act, claiming that new information and circumstances have arisen which justify reconsideration of the permit. By letter of September 30, 2009, the Corps of Engineers advised the EPA that it would not reconsider its decision to issue the permit. By letter of October 16, 2009, the EPA advised the Corps that it has reason to believe that the Mingo Logan mine will have unacceptable adverse impacts to fish and wildlife resources and that it intends to issue a public notice of a proposed determination to restrict or prohibit discharges of fill material that already are approved by the Corps' permit. By federal register publication dated April 2, 2010, the EPA issued its Proposed Determination to Prohibit, Restrict or Deny the Specification, or the Use for Specification of an Area as a Disposal Site: Spruce No. 1 Surface Mine, Logan County, WV pursuant to Section 404(c) of the Clean Water Act, the EPA accepted written comments on its proposed action (sometimes known as a veto proceeding), through June 4, 2010 and conducted a public hearing, as well, on May 18, 2010. We submitted comments on the action during this period. On September 24, 2010, the EPA Region 3 issued a Recommended Determination to the EPA Administrator recommending that the EPA prohibit the placement of fill material in two of the three watersheds for which filling is approved under the current Section 404 permit. Mingo Logan, along with the Corps, West Virginia DEP and the mineral owner, engaged in a consultation with the EPA as required by the regulations, to discuss corrective action to address the unacceptable adverse effects identified. On January 13, 2011, the EPA issued its Final Determination pursuant to Section 404(c) of the Clean Water Act to withdraw the specification of two of the three watersheds approved in the current Section 404 permit as a disposal site for dredged or fill material. By separate action, Mingo Logan sued the EPA on April 2, 2010 in federal court in Washington, D.C. seeking a ruling that the EPA has no authority under the Clean Water Act to veto a previously issued permit (Mingo Logan Coal Company, Inc. v. USEPA, No. 1:10-cv-00541(D.D.C.)). The EPA moved to dismiss that action, and we responded to that motion.

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

On May 11, 2012, the EPA filed a notice of appeal to the United States Court of Appeals for the District of Columbia Circuit. The court heard oral arguments on March 14, 2013. By opinion of the court filed on April 23, 2013, the court reversed the district court on the threshold issue

Edgar Filing: ARCH COAL INC - Form 10-Q

and remanded the matter to the district court to address the merits of our APA challenge to the Final Determination. On June 6, 2013, Mingo Logan filed a Petition for Rehearing En Banc and by Order filed July 25, 2013, the court denied the petition.

On November 13, 2013, Mingo Logan filed a Petition for Writ of Certiorari with the Supreme Court of the United States seeking review of the DC Circuit's decision. On March 24, 2014, the Supreme Court denied Mingo

Table of Contents

Logan's Petition for Writ of Certiorari. The matter will be remanded to the federal district court for the District of Columbia for further proceedings on the merits of the Final Determination.

Allegheny Energy Contract Matter

Allegheny Energy Supply (Allegheny), the sole customer of coal produced at our subsidiary Wolf Run Mining Company's (Wolf Run) Sycamore No. 2 mine, filed a lawsuit against Wolf Run, Hunter Ridge Holdings, Inc. (Hunter Ridge), and ICG in state court in Allegheny County, Pennsylvania on December 28, 2006, and amended its complaint on April 23, 2007. Allegheny claimed that Wolf Run breached a coal supply contract when it declared force majeure under the contract upon idling the Sycamore No. 2 mine in the third quarter of 2006, and that Wolf Run continued to breach the contract by failing to ship in volumes referenced in the contract. The Sycamore No. 2 mine was idled after encountering adverse geologic conditions and abandoned gas wells that were previously unidentified and unmapped.

After extensive searching for gas wells and rehabilitation of the mine, it was re-opened in 2007, but with notice to Allegheny that it would necessarily operate at reduced volumes in order to safely and effectively avoid the many gas wells within the reserve. The amended complaint also alleged that the production stoppages constitute a breach of the guarantee agreement by Hunter Ridge and breach of certain representations made upon entering into the contract in early 2005. Allegheny voluntarily dropped the breach of representation claims later. Allegheny claimed that it would incur costs in excess of \$100 million to purchase replacement coal over the life of the contract. ICG, Wolf Run and Hunter Ridge answered the amended complaint on August 13, 2007, disputing all of the remaining claims.

On November 3, 2008, ICG, Wolf Run and Hunter Ridge filed an amended answer and counterclaim against the plaintiffs seeking to void the coal supply agreement due to, among other things, fraudulent inducement and conspiracy. On September 23, 2009, Allegheny filed a second amended complaint alleging several alternative theories of liability in its effort to extend contractual liability to ICG, which was not a party to the original contract and did not exist at the time Wolf Run and Allegheny entered into the contract. No new substantive claims were asserted. ICG answered the second amended complaint on October 13, 2009, denying all of the new claims. The Company's counterclaim was dismissed on motion for summary judgment entered on May 11, 2010. Allegheny's claims against ICG were also dismissed by summary judgment, but the claims against Wolf Run and Hunter Ridge were not. The court conducted a non-jury trial of this matter beginning on January 10, 2011 and concluding on February 1, 2011.

At the trial, Allegheny presented its evidence for breach of contract and claimed that it is entitled to past and future damages in the aggregate of between \$228 million and \$377 million. Wolf Run and Hunter Ridge presented their defense of the claims, including evidence with respect to the existence of force majeure conditions and excuse under the contract and applicable law. Wolf Run and Hunter Ridge presented evidence that Allegheny's damages calculations were significantly inflated because it did not seek to determine damages as of the time of the breach and in some instances artificially assumed future nondelivery or did not take into account the apparent requirement to supply coal in the future. On May 2, 2011, the trial court entered a Memorandum and Verdict determining that Wolf Run had breached the coal supply contract and that the performance shortfall was not excused by force majeure. The trial court awarded total damages and interest in the amount of \$104.1 million, which consisted of \$13.8 million for past damages, and \$90.3 million for future damages. ICG and Allegheny filed post-verdict motions in the trial court and on August 23, 2011, the court denied the parties' motions. The court entered a final judgment on August 25, 2011, in the amount of \$104.1 million, which included pre-judgment interest.

The parties appealed the lower court's decision to the Superior Court of Pennsylvania. On August 13, 2012, the Superior Court of Pennsylvania affirmed the award of past damages, but ruled that the lower court should have calculated future damages as of the date of breach, and remanded the matter back to the lower court with instructions to recalculate that portion of the award. On November 19, 2012, Allegheny filed a Petition

Edgar Filing: ARCH COAL INC - Form 10-Q

for Allowance of Appeal with the Supreme Court of Pennsylvania and Wolf Run and Hunter Ridge filed an Answer. On July 2, 2013, the Supreme Court of Pennsylvania denied the Petition of Allowance. As this action finalized the past damage award, Wolf Run paid \$15.6 million for the past damage amount, including interest, to Allegheny in July 2013. The future damage award is now back before the lower court, and a new trial has been scheduled to start May 13, 2014.

Table of Contents

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

In September 2006, our board of directors authorized a share repurchase program for the purchase of up to 14,000,000 shares of our common stock. There is no expiration date on the current authorization, and we have not made any decisions to suspend or cancel purchases under the program. As of March 31, 2014, there were 10,925,800 shares of our common stock available for purchase under this program. We did not purchase any shares of our common stock under this program during the quarter ended March 31, 2014. Based on the closing price of our common stock as reported on the New York Stock Exchange on April 30, 2014, the approximate dollar value of our common stock that may yet be purchased under this program was \$50.0 million.

Item 4. Mine Safety Disclosures.

The statement concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of Regulation S-K is included in Exhibit 95 to this Quarterly Report on Form 10-Q for the period ended March 31, 2014.

Table of Contents

Item 6. Exhibits.

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

| | |
|-------|---|
| 10.1* | Form of Performance Shares Contract |
| 12.1 | Computation of ratio of earnings to combined fixed charges and preference dividends. |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of John W. Eaves. |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of John T. Drexler. |
| 32.1 | Section 1350 Certification of John W. Eaves. |
| 32.2 | Section 1350 Certification of John T. Drexler. |
| 95 | Mine Safety Disclosure Exhibit |
| 101 | Interactive Data File (Form 10-Q for the period ended March 31, 2014 filed in XBRL). The financial information contained in the XBRL-related documents is unaudited and unreviewed. |

* Denotes management contract or compensatory plan arrangement.

Signatures

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

Arch Coal, Inc.

By: /s/ John T. Drexler
John T. Drexler
Senior Vice President and Chief Financial Officer
(On behalf of the registrant and as Principal
Financial Officer)

May 12, 2014