

ARCH COAL INC  
Form 10-Q  
November 09, 2010

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

**FORM 10-Q**

(Mark One)

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2010**

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

**Commission file number: 1-13105**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction  
of incorporation or organization)

**43-0921172**

(I.R.S. Employer  
Identification Number)

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

(Address of principal executive offices)

**63141**

(Zip code)

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

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

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

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

Large accelerated  
filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting  
company ☐

(Do not check if a smaller reporting company)

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

At November 5, 2010 there were 162,482,200 shares of the registrant's common stock outstanding.

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Part I  
 FINANCIAL INFORMATION  
**Item 1. Financial Statements.**

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

|                                                                           | Three Months<br>Ended September<br>30 |            | Nine Months Ended<br>September 30 |              |
|---------------------------------------------------------------------------|---------------------------------------|------------|-----------------------------------|--------------|
|                                                                           | 2010                                  | 2009       | 2010                              | 2009         |
|                                                                           | (unaudited)                           |            |                                   |              |
| REVENUES                                                                  |                                       |            |                                   |              |
| Coal sales                                                                | \$ 874,705                            | \$ 614,957 | \$ 2,350,874                      | \$ 1,850,609 |
| COSTS, EXPENSES AND OTHER                                                 |                                       |            |                                   |              |
| Cost of coal sales                                                        | 651,853                               | 489,290    | 1,773,464                         | 1,503,937    |
| Depreciation, depletion and amortization                                  | 92,857                                | 71,390     | 269,135                           | 213,078      |
| Amortization of acquired sales contracts, net                             | 10,038                                | 78         | 26,005                            | (92)         |
| Selling, general and administrative expenses                              | 26,999                                | 24,029     | 89,509                            | 70,770       |
| Change in fair value of coal derivatives and coal trading activities, net | 1,832                                 | (3,342)    | 12,296                            | (10,328)     |
| Gain on Knight Hawk transaction                                           |                                       |            | (41,577)                          |              |
| Costs related to acquisition of Jacobs Ranch                              |                                       | 791        |                                   | 7,166        |
| Other operating income, net                                               | (7,221)                               | (15,617)   | (15,004)                          | (28,141)     |
|                                                                           | 776,358                               | 566,619    | 2,113,828                         | 1,756,390    |
| Income from operations                                                    | 98,347                                | 48,338     | 237,046                           | 94,219       |
| Interest expense, net:                                                    |                                       |            |                                   |              |
| Interest expense                                                          | (37,698)                              | (29,791)   | (107,906)                         | (70,466)     |
| Interest income                                                           | 927                                   | 399        | 1,888                             | 7,284        |
|                                                                           | (36,771)                              | (29,392)   | (106,018)                         | (63,182)     |
| Other non-operating expense:                                              |                                       |            |                                   |              |
| Loss on early extinguishment of debt                                      | (6,776)                               |            | (6,776)                           |              |
|                                                                           | (6,776)                               |            | (6,776)                           |              |
| Income before income taxes                                                | 54,800                                | 18,946     | 124,252                           | 31,037       |
| Provision for (benefit from) income taxes                                 | 7,941                                 | (6,270)    | 12,889                            | (9,590)      |
| Net income                                                                | 46,859                                | 25,216     | 111,363                           | 40,627       |
| Less: Net (income) loss attributable to noncontrolling interest           | (181)                                 | (31)       | (325)                             | 11           |

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|                                             |           |           |            |           |
|---------------------------------------------|-----------|-----------|------------|-----------|
| Net income attributable to Arch Coal, Inc.  | \$ 46,678 | \$ 25,185 | \$ 111,038 | \$ 40,638 |
| <b>EARNINGS PER COMMON SHARE</b>            |           |           |            |           |
| Basic earnings per common share             | \$ 0.29   | \$ 0.16   | \$ 0.68    | \$ 0.28   |
| Diluted earnings per common share           | \$ 0.29   | \$ 0.16   | \$ 0.68    | \$ 0.28   |
| Basic weighted average shares outstanding   | 162,391   | 155,622   | 162,384    | 147,122   |
| Diluted weighted average shares outstanding | 163,174   | 156,005   | 163,128    | 147,332   |
| Dividends declared per common share         | \$ 0.10   | \$ 0.09   | \$ 0.29    | \$ 0.27   |

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

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

|                                                      | September<br>30,<br>2010 | December<br>31,<br>2009 |
|------------------------------------------------------|--------------------------|-------------------------|
|                                                      | (unaudited)              |                         |
| ASSETS                                               |                          |                         |
| Current assets:                                      |                          |                         |
| Cash and cash equivalents                            | \$ 63,753                | \$ 61,138               |
| Trade accounts receivable                            | 249,189                  | 190,738                 |
| Other receivables                                    | 45,590                   | 40,632                  |
| Inventories                                          | 218,958                  | 240,776                 |
| Prepaid royalties                                    | 45,129                   | 21,085                  |
| Deferred income taxes                                | 33,850                   |                         |
| Coal derivative assets                               | 10,322                   | 18,807                  |
| Other                                                | 96,633                   | 113,606                 |
| Total current assets                                 | 763,424                  | 686,782                 |
| Property, plant and equipment, net                   | 3,303,028                | 3,366,186               |
| Other assets:                                        |                          |                         |
| Prepaid royalties                                    | 60,103                   | 86,622                  |
| Goodwill                                             | 113,701                  | 113,701                 |
| Deferred income taxes                                | 323,874                  | 354,869                 |
| Equity investments                                   | 148,893                  | 87,268                  |
| Other                                                | 121,763                  | 145,168                 |
| Total other assets                                   | 768,334                  | 787,628                 |
| Total assets                                         | \$ 4,834,786             | \$ 4,840,596            |
| LIABILITIES AND STOCKHOLDERS EQUITY                  |                          |                         |
| Current liabilities:                                 |                          |                         |
| Accounts payable                                     | \$ 172,281               | \$ 128,402              |
| Coal derivative liabilities                          | 5,721                    | 2,244                   |
| Deferred income taxes                                |                          | 5,901                   |
| Accrued expenses and other current liabilities       | 200,868                  | 227,716                 |
| Current maturities of debt and short-term borrowings | 139,334                  | 267,464                 |
| Total current liabilities                            | 518,204                  | 631,727                 |
| Long-term debt                                       | 1,538,470                | 1,540,223               |
| Asset retirement obligations                         | 323,025                  | 305,094                 |
| Accrued pension benefits                             | 64,145                   | 68,266                  |

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|                                                                                                                   |              |              |
|-------------------------------------------------------------------------------------------------------------------|--------------|--------------|
| Accrued postretirement benefits other than pension                                                                | 45,609       | 43,865       |
| Accrued workers' compensation                                                                                     | 28,226       | 29,110       |
| Other noncurrent liabilities                                                                                      | 120,058      | 98,243       |
| Total liabilities                                                                                                 | 2,637,737    | 2,716,528    |
| Redeemable noncontrolling interest                                                                                | 10,173       | 8,962        |
| Stockholders' equity:                                                                                             |              |              |
| Common stock, \$0.01 par value, authorized 260,000 shares, issued 163,991 shares and 163,953 shares, respectively | 1,643        | 1,643        |
| Paid-in capital                                                                                                   | 1,731,209    | 1,721,230    |
| Treasury stock, 1,512 shares at September 30, 2010 and December 31, 2009, at cost                                 | (53,848)     | (53,848)     |
| Retained earnings                                                                                                 | 529,852      | 465,934      |
| Accumulated other comprehensive loss                                                                              | (21,980)     | (19,853)     |
| Total stockholders' equity                                                                                        | 2,186,876    | 2,115,106    |
| Total liabilities and stockholders' equity                                                                        | \$ 4,834,786 | \$ 4,840,596 |

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

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

|                                                                                          | <b>Nine Months Ended September<br/>30</b> |               |
|------------------------------------------------------------------------------------------|-------------------------------------------|---------------|
|                                                                                          | <b>2010</b>                               | <b>2009</b>   |
|                                                                                          | (unaudited)                               |               |
| <b>OPERATING ACTIVITIES</b>                                                              |                                           |               |
| Net income                                                                               | \$ 111,363                                | \$ 40,627     |
| Adjustments to reconcile net income to cash provided by operating activities:            |                                           |               |
| Depreciation, depletion and amortization                                                 | 269,135                                   | 213,078       |
| Amortization of acquired sales contracts, net                                            | 26,005                                    | (92)          |
| Prepaid royalties expensed                                                               | 26,190                                    | 24,140        |
| Employee stock-based compensation                                                        | 9,640                                     | 10,253        |
| Amortization of debt financing costs                                                     | 7,395                                     | 5,053         |
| Gain on Knight Hawk transaction                                                          | (41,577)                                  |               |
| Loss on early extinguishment of debt                                                     | 6,776                                     |               |
| Changes in:                                                                              |                                           |               |
| Receivables                                                                              | (48,718)                                  | 63,785        |
| Inventories                                                                              | 21,818                                    | (45,725)      |
| Coal derivative assets and liabilities                                                   | 14,116                                    | 21,911        |
| Accounts payable, accrued expenses and other current liabilities                         | 20,879                                    | (74,607)      |
| Deferred income taxes                                                                    | (7,561)                                   | (15,165)      |
| Other                                                                                    | 41,219                                    | 3,185         |
| <br>Cash provided by operating activities                                                | <br>456,680                               | <br>246,443   |
| <br><b>INVESTING ACTIVITIES</b>                                                          |                                           |               |
| Capital expenditures                                                                     | (221,583)                                 | (280,033)     |
| Proceeds from dispositions of property, plant and equipment                              | 252                                       | 806           |
| Purchases of investments and advances to affiliates                                      | (16,740)                                  | (10,353)      |
| Additions to prepaid royalties                                                           | (23,715)                                  | (22,874)      |
| Reimbursement of deposits on equipment                                                   |                                           | 3,209         |
| <br>Cash used in investing activities                                                    | <br>(261,786)                             | <br>(309,245) |
| <br><b>FINANCING ACTIVITIES</b>                                                          |                                           |               |
| Proceeds from the issuance of long-term debt                                             | 500,000                                   | 584,784       |
| Repayments of long-term debt, including redemption premium                               | (505,627)                                 |               |
| Proceeds from the sale of common stock                                                   |                                           | 326,452       |
| Net increase (decrease) in borrowings under lines of credit and commercial paper program | (118,337)                                 | 4,345         |
| Net payments on other debt                                                               | (9,794)                                   | (13,276)      |
| Debt financing costs                                                                     | (12,630)                                  | (29,596)      |



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|                                                 |           |            |
|-------------------------------------------------|-----------|------------|
| Dividends paid                                  | (47,121)  | (40,347)   |
| Issuance of common stock under incentive plans  | 339       | 84         |
| Contribution from noncontrolling interest       | 891       |            |
| Cash provided by (used in) financing activities | (192,279) | 832,446    |
| Increase in cash and cash equivalents           | 2,615     | 769,644    |
| Cash and cash equivalents, beginning of period  | 61,138    | 70,649     |
| Cash and cash equivalents, end of period        | \$ 63,753 | \$ 840,293 |

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

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

**1. Basis of Presentation**

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

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial reporting and U.S. Securities and Exchange Commission regulations. In the opinion of management, all adjustments, consisting of normal, recurring accruals considered necessary for a fair presentation, have been included. Results of operations for the three and nine month periods ended September 30, 2010 are not necessarily indicative of results to be expected for the year ending December 31, 2010. 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, 2009 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission.

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

**2. Accounting Policies**

There are no new accounting pronouncements whose adoption is expected to have a material impact on the Company's consolidated financial statements.

**3. Knight Hawk Transaction**

In the second quarter of 2010, the Company exchanged 68.4 million tons of coal reserves in the Illinois Basin for an additional 9% ownership interest in Knight Hawk Holdings, LLC (Knight Hawk), increasing the Company's ownership in Knight Hawk to 42%. The Company recognized a gain of \$41.6 million on the transaction, representing the difference between the fair value and the \$12.1 million net book value of the coal reserves, adjusted for the Company's retained ownership interest in the reserves through its investment in Knight Hawk.

**4. Property Transactions**

On March 18, 2010, the Company was awarded a Montana state coal lease for the Otter Creek tracts for a price of \$85.8 million. The Company now controls approximately 1.5 billion tons of coal reserves in Montana's Otter Creek area, including a coal lease secured in November 2009.

Payments to acquire non-cancelable royalty lease agreements and federal lease bonus payments under which future minimum payments are due are capitalized as a cost of the underlying mineral reserves. During the nine months ended September 30, 2010, the Company made payments of \$93.1 million related to these agreements, including the Otter Creek lease, and will make a payment of \$16.1 million in the fourth quarter. Future payments under these arrangements will be \$23.4 million in 2011, 2012 and 2013 and \$7.3 million in 2014.

**5. Fair Value Measurements**

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

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

Level 2 is defined as observable inputs other than Level 1 prices. These include quoted prices for similar



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

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

The table below sets forth, by level, the Company's financial assets and liabilities that are accounted for at fair value:

|                                  | <b>Fair Value at September 30, 2010</b> |                       |                  |                 |
|----------------------------------|-----------------------------------------|-----------------------|------------------|-----------------|
|                                  | <b>Total</b>                            | <b>Level 1</b>        | <b>Level 2</b>   | <b>Level 3</b>  |
|                                  |                                         | <b>(In thousands)</b> |                  |                 |
| <b>Assets:</b>                   |                                         |                       |                  |                 |
| Investments in equity securities | \$ 4,347                                | \$ 3,990              | \$               | \$ 357          |
| Derivatives                      | 20,926                                  |                       | 14,273           | 6,653           |
| <b>Total assets</b>              | <b>\$ 25,273</b>                        | <b>\$ 3,990</b>       | <b>\$ 14,273</b> | <b>\$ 7,010</b> |
| <b>Liabilities:</b>              |                                         |                       |                  |                 |
| Derivatives                      | \$ 5,721                                | \$ 3,509              | \$ 2,660         | \$ (448)        |

The Company's contracts with certain of its counterparties allow for the settlement of contracts in an asset position with contracts in a liability position in the event of default or termination. For classification purposes, the Company records the net fair value of all the positions with these counterparties as a net asset or liability. Each level in the table above displays the underlying contracts according to their classification in the accompanying condensed consolidated balance sheet, based on this counterparty netting.

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

|                                                                                 | <b>Three Months Ended September 30, 2010</b> | <b>Nine Months Ended September 30, 2010</b> |
|---------------------------------------------------------------------------------|----------------------------------------------|---------------------------------------------|
|                                                                                 | <b>(In thousands)</b>                        |                                             |
| Balance, beginning of period                                                    | \$ 7,403                                     | \$ 8,217                                    |
| Realized and unrealized losses recognized in earnings                           | (1,844)                                      | (7,220)                                     |
| Realized and unrealized gains (losses) recognized in other comprehensive income | 2,411                                        | (3,708)                                     |
| Settlements, purchases and issuances                                            | (512)                                        | 10,169                                      |
| <b>Balance, end of period</b>                                                   | <b>\$ 7,458</b>                              | <b>\$ 7,458</b>                             |

Net unrealized gains (losses) during the three and nine month periods ended September 30, 2010 related to level 3 financial instruments held on September 30, 2010 were \$0.1 million and \$(5.6) million, respectively.

*Fair Value of Long-Term Debt*

At September 30, 2010 and December 31, 2009, the fair value of the Company's senior notes and other long-term debt, including amounts classified as current, was \$1,784.0 million and \$1,844.1 million, respectively. Fair values are based upon observed prices in an active market when available or from valuation models using market information.

**6. Derivatives**

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

All derivative financial instruments are recognized in the balance sheet at fair value. In a fair value hedge, the Company hedges the risk of changes in the fair value of a firm commitment, typically a fixed-price coal sales contract. Changes in both the hedged firm commitment and the fair value of a derivative used as a hedge instrument in a fair value hedge are recorded in earnings. In a cash flow hedge, the Company hedges the risk of changes in future cash flows related to a

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forecasted purchase or sale. Changes in the fair value of the derivative instrument used as a hedge instrument in a cash flow hedge are recorded in other comprehensive income. Amounts in other comprehensive income are reclassified to earnings when the hedged transaction affects earnings and are classified in a manner consistent with the transaction being hedged. The Company formally documents the relationships between hedging instruments and the respective hedged items, as well as its risk management objectives for hedge transactions.

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

### *Diesel fuel price risk management*

The Company is exposed to price risk with respect to diesel fuel purchased for use in its operations. The Company purchases approximately 60 million to 70 million gallons of diesel fuel annually in its operations. To reduce the volatility in the price of diesel fuel for its operations, the Company uses forward physical diesel purchase contracts, as well as heating oil swaps and purchased call options. At September 30, 2010, the Company had protected the price of approximately 67% of its remaining expected purchases for fiscal year 2010 and 55% for fiscal year 2011.

At September 30, 2010, the Company held heating oil swaps and purchased call options for approximately 47.6 million gallons for the purpose of managing the price risk associated with future diesel purchases. Since the changes in the price of heating oil highly correlate to changes in the price of the hedged diesel fuel purchases, the heating oil swaps and purchased call options qualify for cash flow hedge accounting.

### *Coal risk management positions*

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

At September 30, 2010, the Company held derivatives for risk management purposes totaling 0.8 million tons of coal sales and 0.7 million tons of coal purchases that are expected to settle during the remainder of 2010 and 1.0 million tons of coal sales and 0.1 million tons of coal purchases that are expected to settle in 2011.

### *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 \$1.4 million for the remainder of 2010, \$4.6 million in 2011 and \$(0.8) million in 2012.

**Table of Contents***Tabular derivatives disclosures*

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

**Fair Value of Derivatives**

(in thousands)

|                                                                   | <b>September 30, 2010</b>    |                                  | <b>December 31, 2009</b>     |                                  |
|-------------------------------------------------------------------|------------------------------|----------------------------------|------------------------------|----------------------------------|
|                                                                   | <b>Asset<br/>Derivatives</b> | <b>Liability<br/>Derivatives</b> | <b>Asset<br/>Derivatives</b> | <b>Liability<br/>Derivatives</b> |
| <b>Derivatives Designated<br/>as Hedging Instruments</b>          |                              |                                  |                              |                                  |
| Heating oil                                                       | \$ 10,604                    | \$                               | \$ 13,954                    | \$ (2,432)                       |
| Coal                                                              | 3,476                        | (4,884)                          | 3,075                        | (6,355)                          |
| Total                                                             | 14,080                       | (4,884)                          | 17,029                       | (8,787)                          |
| <b>Derivatives Not<br/>Designated as Hedging<br/>Instruments</b>  |                              |                                  |                              |                                  |
| Coal held for trading<br>purposes                                 | 20,735                       | (15,605)                         | 41,544                       | (31,262)                         |
| Coal                                                              | 2,860                        | (1,981)                          | 11,459                       | (1,898)                          |
| Total                                                             | 23,595                       | (17,586)                         | 53,003                       | (33,160)                         |
| Total derivatives                                                 | 37,675                       | (22,470)                         | 70,032                       | (41,947)                         |
| Effect of counterparty<br>netting                                 | (16,749)                     | 16,749                           | (39,227)                     | 39,227                           |
| <b>Net derivatives as<br/>classified in the balance<br/>sheet</b> | <b>\$ 20,926</b>             | <b>\$ (5,721)</b>                | <b>\$ 15,205</b>             | <b>\$ 30,805</b>                 |
|                                                                   |                              |                                  |                              | <b>\$ (2,720)</b>                |
|                                                                   |                              |                                  |                              | <b>\$ 28,085</b>                 |

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

|                    |                                                | <b>September<br/>30,<br/>2010</b> | <b>December<br/>31,<br/>2009</b> |
|--------------------|------------------------------------------------|-----------------------------------|----------------------------------|
| <b>Heating oil</b> | Other current assets                           | \$ 10,604                         | \$ 11,998                        |
|                    | Accrued expenses and other current liabilities |                                   | (476)                            |
| <b>Coal</b>        | Coal derivative assets                         | 10,322                            | 18,807                           |
|                    | Coal derivative liabilities                    | (5,721)                           | (2,244)                          |
|                    |                                                | <b>\$ 15,205</b>                  | <b>\$ 28,085</b>                 |

The Company had a current asset for the right to reclaim cash collateral of \$12.9 million and \$12.5 million at September 30, 2010 and December 31, 2009, respectively. These amounts are not included with the derivatives presented in the table above and are included in other current assets in the accompanying condensed consolidated balance sheets.



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

**Three Months Ended September 30**

(in thousands)

| Derivatives used in<br>Fair Value Hedging Relationships | Gain on<br>Derivatives<br>Used in Fair<br>Value<br>Hedge<br>Relationships |          |   | Hedged Items in<br>Fair Value Hedge<br>Hedge Relationships | Loss on Hedged<br>Items In Fair<br>Value<br>Hedge<br>Relationships |            |   |
|---------------------------------------------------------|---------------------------------------------------------------------------|----------|---|------------------------------------------------------------|--------------------------------------------------------------------|------------|---|
|                                                         | 2010                                                                      | 2009     |   |                                                            | 2010                                                               | 2009       |   |
| Coal                                                    | \$                                                                        | \$ 2,235 | 1 | Firm commitments                                           | \$                                                                 | \$ (2,235) | 1 |

| Derivatives used in<br>Cash Flow Hedging Relationships | Gain (Loss)<br>Recognized in OCI<br>(Effective Portion) |            | Gains (Losses)<br>Reclassified from<br>OCI into Income<br>(Effective Portion) |             |   | Gain (Loss)<br>Recognized in<br>Income<br>(Ineffective<br>Portion and<br>Amount<br>Excluded from<br>Effectiveness<br>Testing) |      |
|--------------------------------------------------------|---------------------------------------------------------|------------|-------------------------------------------------------------------------------|-------------|---|-------------------------------------------------------------------------------------------------------------------------------|------|
|                                                        | 2010                                                    | 2009       | 2010                                                                          | 2009        |   | 2010                                                                                                                          | 2009 |
| Heating oil                                            | \$ 3,052                                                | \$ (2,393) | \$ 93                                                                         | \$ (11,854) | 2 | \$                                                                                                                            | \$   |
| Coal sales                                             | 1,500                                                   | (4,739)    | (226)                                                                         |             | 1 |                                                                                                                               |      |
| Coal purchases                                         | (2,535)                                                 | 3,407      | (866)                                                                         | (5,652)     | 2 |                                                                                                                               |      |
| Totals                                                 | \$ 2,017                                                | \$ (3,725) | \$ (999)                                                                      | \$ (17,506) |   | \$                                                                                                                            | \$   |

| Derivatives Not Designated as<br>Hedging Instruments |            | Gain (Loss) |          |
|------------------------------------------------------|------------|-------------|----------|
|                                                      |            | 2010        | 2009     |
| Coal                                                 | unrealized | \$ (993)    | \$ 7,881 |
|                                                      |            |             | 3        |
| Coal                                                 | realized   | \$ 1,079    | \$       |
|                                                      |            |             | 4        |

**Location in Statement of Income:**

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

During the three months ended September 30, 2010 and 2009, the Company recognized net unrealized and realized losses of \$0.8 million and \$4.5 million, respectively, related to its trading portfolio (including derivative and non-derivative contracts). These balances are included in the caption Change in fair value of coal derivatives and coal trading activities, net in the accompanying condensed consolidated statements of income and are not included in the previous table.

**Nine Months Ended September 30**  
(in thousands)

| Derivatives used in<br>Fair Value Hedging Relationships | Gain on<br>Derivatives<br>Used in Fair<br>Value<br>Hedge<br>Relationships |        |   | Hedged Items in<br>Fair Value Hedge<br>Hedge Relationships | Loss on Hedged<br>Items In Fair<br>Value<br>Hedge<br>Relationships |          |   |
|---------------------------------------------------------|---------------------------------------------------------------------------|--------|---|------------------------------------------------------------|--------------------------------------------------------------------|----------|---|
|                                                         | 2010                                                                      | 2009   |   |                                                            | 2010                                                               | 2009     |   |
| Coal                                                    | \$                                                                        | \$ 651 | 1 | Firm commitments                                           | \$                                                                 | \$ (651) | 1 |

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| Derivatives used in             | Gain (Loss)         |          | Losses                            |               | Gain (Loss)                                                          |      |
|---------------------------------|---------------------|----------|-----------------------------------|---------------|----------------------------------------------------------------------|------|
|                                 | Recognized in OCI   |          | Reclassified from OCI into Income |               | Recognized in Income                                                 |      |
|                                 | (Effective Portion) |          | (Effective Portion)               |               | (Ineffective Portion and Amount Excluded from Effectiveness Testing) |      |
|                                 | 2010                | 2009     | 2010                              | 2009          | 2010                                                                 | 2009 |
| Cash Flow Hedging Relationships |                     |          |                                   |               |                                                                      |      |
| Heating oil                     | \$ (5,508)          | \$ 6,346 | \$ (211)                          | \$ (38,438) 2 | \$                                                                   | \$   |
| Coal sales                      | (6,138)             | (6,055)  | (1,556)                           | (2,984) 1     |                                                                      |      |
| Coal purchases                  | 5,534               | (1,095)  | (1,202)                           | (11,092) 2    |                                                                      |      |
| Totals                          | \$ (6,112)          | \$ (804) | \$ (2,969)                        | \$ (52,514)   | \$                                                                   | \$   |

| Derivatives Not Designated as Hedging Instruments | Gain (Loss) |            |
|---------------------------------------------------|-------------|------------|
|                                                   | 2010        | 2009       |
| Coal unrealized                                   | \$ (9,381)  | \$ 8,569 3 |
| Coal realized                                     | \$ 3,931    | \$ 4       |

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

During the nine months ended September 30, 2010 and 2009, the Company recognized net unrealized and realized losses of \$2.9 million and net unrealized and realized gains of \$1.8 million, respectively, related to its trading portfolio (including derivative and non-derivative contracts). These balances are included in the caption Change in fair value of coal derivatives and coal trading activities, net in the accompanying condensed consolidated statements of income and are not included in the previous table.

During the next twelve months, based on fair values at September 30, 2010, gains on derivative contracts designated as hedge instruments in cash flow hedges of approximately \$7.9 million are expected to be reclassified from other comprehensive income into earnings.

**7. Inventories**

Inventories consist of the following:

| September<br>30,<br>2010 | December<br>31,<br>2009 |
|--------------------------|-------------------------|
|--------------------------|-------------------------|

|                                             | <b>(In thousands)</b> |            |
|---------------------------------------------|-----------------------|------------|
| Coal                                        | \$ 96,139             | \$ 99,161  |
| Repair parts and supplies, net of allowance | 122,819               | 141,615    |
|                                             | \$ 218,958            | \$ 240,776 |

The repair parts and supplies are stated net of an allowance for slow-moving and obsolete inventories of \$14.2 million at September 30, 2010, and \$13.4 million at December 31, 2009.

**Table of Contents****8. Debt**

|                                                                                                    | September<br>30,<br>2010 | December<br>31,<br>2009 |
|----------------------------------------------------------------------------------------------------|--------------------------|-------------------------|
|                                                                                                    | (In thousands)           |                         |
| Commercial paper                                                                                   | \$ 55,716                | \$ 49,453               |
| Indebtedness to banks under credit facilities                                                      | 79,400                   | 204,000                 |
| 6.75% senior notes (\$450.0 million and \$950.0 million face value, respectively) due July 1, 2013 | 451,780                  | 954,782                 |
| 8.75% senior notes (\$600.0 million face value) due August 1, 2016                                 | 586,690                  | 585,441                 |
| 7.25% senior notes (\$500.0 million face value) due October 1, 2020                                | 500,000                  |                         |
| Other                                                                                              | 4,218                    | 14,011                  |
|                                                                                                    | 1,677,804                | 1,807,687               |
| Less current maturities of debt and short-term borrowings                                          | 139,334                  | 267,464                 |
| Long-term debt                                                                                     | \$ 1,538,470             | \$ 1,540,223            |

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

*Refinancing of senior notes*

On August 9, 2010, the Company issued \$500.0 million in aggregate principal amount of 7.25% senior unsecured notes due in 2020 at par. The Company used the net proceeds from the offering and cash on hand to fund the redemption on September 8, 2010 of \$500.0 million aggregate principal amount of its outstanding 6.75% senior notes at a redemption price of 101.125%. The Company recognized a loss on the redemption of \$6.8 million, including the payment of the \$5.6 million redemption premium and the write-off of \$3.3 million of unamortized debt financing costs, partially offset by the write-off of \$2.1 million of the original issue premium on the 6.75% senior notes.

Interest is payable on the 7.25% senior notes on April 1 and October 1 of each year, commencing April 1, 2011. The notes are guaranteed by most of the Company's subsidiaries, except for Arch Western and its subsidiaries and Arch Receivable Company, LLC. If the Company fails to meet a coverage ratio test as defined in the indenture, the ability of the Company and its subsidiaries to incur additional debt; pay dividends and make distributions or repurchase stock; make investments; create liens; issue and sell capital stock of subsidiaries; sell assets; enter into restrictions affecting the ability of restricted subsidiaries to make distributions, loans or advances to the Company; engage in transactions with affiliates; enter into sale and leasebacks; and merge or consolidate or transfer and sell assets would be limited.

At any time on or after October 1, 2015, the Company may redeem some or all of the notes. The redemption price reflected as a percentage of the principal amount is: 103.625% for notes redeemed between October 1, 2015 and September 30, 2016; 102.417% for notes redeemed between October 1, 2016 and September 30, 2017; 101.208% for notes redeemed between October 1, 2017 and September 30, 2018; and 100% for notes redeemed on or after October 1, 2018. In addition, at any time and from time to time, prior to October 1, 2013, on one or more occasions, the Company may redeem an aggregate principal amount of senior notes not to exceed 35% of the original aggregate principal amount of the senior notes outstanding with the proceeds of one or more public equity offerings, at a redemption price equal to 107.250%. Upon a change of control involving the Company, holders of notes have the right to require the Company to repurchase all of their senior notes at a repurchase price equal to 101% of their principal amount, plus accrued and unpaid interest, if any, to the date of repurchase.

*Amendments to agreements*

On February 24, 2010, the Company entered into an amendment to its accounts receivable securitization program revising certain terms to expand the pool of receivables included in the program. The credit facility supporting the borrowings under the program was also renewed and now expires on February 23, 2011. The size of the program continues to allow for aggregate borrowings and letters of credit of up to \$175.0 million, as limited by eligible accounts receivable.

On March 19, 2010 the Company entered into an amendment to its \$860.0 million secured revolving credit facility. The amendment enables Arch Coal to make certain intercompany loans to its subsidiary, Arch Western Resources LLC ( AWR ), without repaying the existing loan from AWR to Arch Coal.

On March 25, 2010, the Company entered into an amendment to its commercial paper program which decreased the maximum aggregate principal amount of the program to \$75 million from \$100 million. The commercial paper program is supported by a line of credit that expires on April 30, 2011.

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The Company had no borrowings outstanding under the revolving credit facility as of September 30, 2010 and \$120.0 million in borrowings outstanding as of December 31, 2009. At September 30, 2010, the Company had availability of \$860.0 million under the revolving credit facility. The Company had borrowings under the accounts receivable securitization program of \$79.4 million and \$84.0 million at September 30, 2010 and December 31, 2009, respectively. The Company also had letters of credit outstanding under the accounts receivable securitization program of \$65.5 million as of September 30, 2010. At September 30, 2010, the Company had availability of \$30.1 million under the accounts receivable securitization program.

**9. Stock-Based Compensation**

During the nine months ended September 30, 2010, the Company granted options to purchase approximately 0.8 million shares of common stock with a weighted average exercise price of \$22.64 per share and a weighted average grant-date fair value of \$9.43 per share. The options' fair value was determined using the Black-Scholes option pricing model, using a weighted average risk-free rate of 2.16%, a weighted average dividend yield of 1.99% and a weighted average volatility of 57.11%. The options' expected life is 4.5 years and the options vest ratably over four years. The options provide for the continuation of vesting for retirement-eligible recipients that meet certain criteria. The expense for these options will be recognized through the date that the employee first becomes eligible to retire and is no longer required to provide service to earn all or part of the award.

The Company recognized stock-based compensation expense from all plans of \$2.2 million and \$3.4 million for the three months ended September 30, 2010 and 2009, respectively, and \$9.6 million and \$10.3 million for the nine months ended September 30, 2010 and 2009, respectively. This expense is primarily included in selling, general and administrative expenses in the accompanying condensed consolidated statements of income.

**10. Workers' Compensation Expense**

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

|                                             | <b>Three Months Ended<br/>September 30</b> |             | <b>Nine Months Ended<br/>September 30</b> |             |
|---------------------------------------------|--------------------------------------------|-------------|-------------------------------------------|-------------|
|                                             | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
|                                             | <b>(In thousands)</b>                      |             |                                           |             |
| Self-insured occupational disease benefits: |                                            |             |                                           |             |
| Service cost                                | \$ 182                                     | \$ 132      | \$ 545                                    | \$ 398      |
| Interest cost                               | 169                                        | 139         | 507                                       | 418         |
| Net amortization                            | (465)                                      | (719)       | (1,395)                                   | (2,159)     |
| Total occupational disease                  | (114)                                      | (448)       | (343)                                     | (1,343)     |
| Traumatic injury claims and assessments     | 2,642                                      | 2,781       | 6,562                                     | 6,333       |
| Total workers' compensation expense         | \$ 2,528                                   | \$ 2,333    | \$ 6,219                                  | \$ 4,990    |

**11. Employee Benefit Plans**

The following table details the components of pension benefit costs:

|                                    | <b>Three Months Ended<br/>September 30</b> |             | <b>Nine Months Ended<br/>September 30</b> |             |
|------------------------------------|--------------------------------------------|-------------|-------------------------------------------|-------------|
|                                    | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
|                                    | <b>(In thousands)</b>                      |             |                                           |             |
| Service cost                       | \$ 3,967                                   | \$ 3,360    | \$ 11,902                                 | \$ 10,082   |
| Interest cost                      | 3,955                                      | 3,981       | 11,866                                    | 11,943      |
| Expected return on plan assets     | (4,848)                                    | (4,429)     | (14,544)                                  | (13,289)    |
| Amortization of prior service cost | 44                                         | 48          | 130                                       | 145         |

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|                                                  |          |          |           |           |
|--------------------------------------------------|----------|----------|-----------|-----------|
| Amortization of other actuarial gains and losses | 1,782    | 992      | 5,348     | 2,975     |
| Curtailments                                     |          |          |           | 586       |
|                                                  | \$ 4,900 | \$ 3,952 | \$ 14,702 | \$ 12,442 |

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

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|                                                  | <b>Three Months Ended<br/>September 30</b> |             | <b>Nine Months Ended<br/>September 30</b> |             |
|--------------------------------------------------|--------------------------------------------|-------------|-------------------------------------------|-------------|
|                                                  | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
|                                                  | <b>(In thousands)</b>                      |             |                                           |             |
| Service cost                                     | \$ 378                                     | \$ 815      | \$ 1,132                                  | \$ 2,446    |
| Interest cost                                    | 520                                        | 1,009       | 1,562                                     | 3,026       |
| Amortization of prior service cost (credit)      | (591)                                      | 946         | (1,773)                                   | 2,836       |
| Amortization of other actuarial gains and losses | (729)                                      | (853)       | (2,188)                                   | (2,559)     |
|                                                  | \$ (422)                                   | \$ 1,917    | \$ (1,267)                                | \$ 5,749    |

**12. Comprehensive Income**

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

The following table presents the components of comprehensive income:

|                                                                                               | <b>Three Months Ended<br/>September 30</b> |             | <b>Nine Months Ended<br/>September 30</b> |             |
|-----------------------------------------------------------------------------------------------|--------------------------------------------|-------------|-------------------------------------------|-------------|
|                                                                                               | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
|                                                                                               | <b>(In thousands)</b>                      |             |                                           |             |
| Net income attributable to Arch Coal, Inc.                                                    | \$ 46,678                                  | \$ 25,185   | \$ 111,038                                | \$ 40,638   |
| Other comprehensive income, net of income taxes:                                              |                                            |             |                                           |             |
| Pension, postretirement and other post-employment benefits, reclassifications into net income | 28                                         | 13,889      | 84                                        | 14,680      |
| Unrealized gains (losses) on available-for-sale securities                                    | 738                                        | (38)        | (178)                                     | (132)       |
| Unrealized gains (losses) on derivatives, net of reclassifications into net income:           |                                            |             |                                           |             |
| Unrealized gains (losses) on derivatives                                                      | 1,200                                      | (2,456)     | (3,889)                                   | (586)       |
| Reclassifications of losses into net income                                                   | 639                                        | 10,892      | 1,856                                     | 33,297      |
| Total comprehensive income                                                                    | \$ 49,283                                  | \$ 47,472   | \$ 108,911                                | \$ 87,897   |

**13. Earnings per Share**

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

|                                                          | <b>Three Months Ended<br/>September 30</b> |             | <b>Nine Months Ended<br/>September 30</b> |             |
|----------------------------------------------------------|--------------------------------------------|-------------|-------------------------------------------|-------------|
|                                                          | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
|                                                          | <b>(In thousands)</b>                      |             |                                           |             |
| Weighted average shares outstanding:                     |                                            |             |                                           |             |
| Basic weighted average shares outstanding                | 162,391                                    | 155,622     | 162,384                                   | 147,122     |
| Effect of common stock equivalents under incentive plans | 783                                        | 383         | 744                                       | 210         |

|                                             |         |         |         |         |
|---------------------------------------------|---------|---------|---------|---------|
| Diluted weighted average shares outstanding | 163,174 | 156,005 | 163,128 | 147,332 |
|---------------------------------------------|---------|---------|---------|---------|

The effect of options to purchase 3.4 million and 2.7 million shares of common stock were excluded from the calculation of diluted weighted average shares outstanding for the three month periods ended September 30, 2010 and 2009, respectively, because the exercise price of these options exceeded the average market price of the Company's common stock for these periods. The effect of options to purchase 2.7 million and 2.1 million shares of common stock were excluded from the calculation of diluted weighted average shares outstanding for the nine month periods ended September 30, 2010 and 2009, respectively, because the exercise price of these options exceeded the average market price of the Company's common stock for these periods.

#### **14. Guarantees**

The Company has agreed to continue to provide surety bonds and letters of credit for the reclamation and retiree healthcare obligations of Magnum Coal Company (Magnum) related to the properties the Company sold to Magnum on

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December 31, 2005. The purchase agreement requires Magnum to reimburse the Company for costs related to the surety bonds and letters of credit and to use commercially reasonable efforts to replace the obligations. If the surety bonds and letters of credit related to the reclamation obligations are not replaced by Magnum within a specified period of time, Magnum must post a letter of credit in favor of the Company in the amounts of the reclamation obligations. At September 30, 2010, the Company had approximately \$91.6 million of surety bonds related to properties sold to Magnum. As a result of Magnum's purchase by Patriot Coal Corporation, Magnum will be required to post letters of credit in the Company's favor for the full amount of the reclamation obligation on or before February 2011.

Magnum also acquired certain coal supply contracts with customers who have not consented to the contracts assignment from the Company to Magnum. The Company has committed to purchase coal from Magnum to sell to those customers at the same price it is charging the customers for the sale. In addition, certain contracts were assigned to Magnum, but the Company has guaranteed Magnum's performance under the contracts. The longest of the coal supply contracts extends to the year 2017. If Magnum is unable to supply the coal for these coal sales contracts then the Company would be required to purchase coal on the open market or supply contracts from its existing operations. At market prices effective at September 30, 2010, the cost of purchasing 11.9 million tons of coal to supply the contracts that have not been assigned over their duration would exceed the sales price under the contracts by approximately \$310.2 million, and the cost of purchasing 1.8 million tons of coal to supply the assigned and guaranteed contracts over their duration would exceed the sales price under the contracts by approximately \$38.0 million. The Company has also guaranteed Magnum's performance under certain operating leases, the longest of which extends through 2011. If the Company were required to perform under its guarantees of the operating lease agreements, it would be required to make \$1.1 million of lease payments. As the Company does not believe that it is probable that it would have to purchase replacement coal or fulfill its obligations under the lease guarantees, no losses have been recorded in the condensed consolidated financial statements as of September 30, 2010. However, if the Company would have to perform under these guarantees, it could potentially have a material adverse effect on the business, results of operations and financial condition of the Company.

In connection with the Company's acquisition of the coal operations of Atlantic Richfield Company (ARCO) and the simultaneous combination of the acquired ARCO operations and the Company's Wyoming operations into the Arch Western joint venture, the Company agreed to indemnify the other member of Arch Western against certain tax liabilities in the event that such liabilities arise prior to June 1, 2013 as a result of certain actions taken, including the sale or other disposition of certain properties of Arch Western, the repurchase of certain equity interests in Arch Western by Arch Western or the reduction under certain circumstances of indebtedness incurred by Arch Western in connection with the acquisition. If the Company were to become liable, the maximum amount of potential future tax payments is \$33.8 million at September 30, 2010, which is not recorded as a liability in the Company's condensed consolidated financial statements. Since the indemnification is dependent upon the initiation of activities within the Company's control and the Company does not intend to initiate such activities, it is remote that the Company will become liable for any obligation related to this indemnification. However, if such indemnification obligation were to arise, it could potentially have a material adverse effect on the business, results of operations and financial condition of the Company.

**15. Contingencies**

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

**16. Segment Information**

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

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

Operating segment results for the three and nine month periods ended September 30, 2010 and 2009 are presented below. Results for the operating segments include all direct costs of mining, including all depreciation, depletion and

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amortization related to the mining operations. Corporate, Other and Eliminations includes the change in fair value of coal derivatives and coal trading activities, net; corporate overhead; land management; other support functions; and the elimination of intercompany transactions.

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

|                                                  | <b>PRB</b>   | <b>WBIT</b> | <b>CAPP<br/>(In<br/>thousands)</b> | <b>Corporate,<br/>Other and<br/>Eliminations</b> | <b>Consolidated</b> |
|--------------------------------------------------|--------------|-------------|------------------------------------|--------------------------------------------------|---------------------|
| <b>Three months ended<br/>September 30, 2010</b> |              |             |                                    |                                                  |                     |
| Coal sales                                       | \$ 440,439   | \$ 138,039  | \$ 296,227                         | \$                                               | \$ 874,705          |
| Income from operations                           | 51,787       | 14,816      | 55,664                             | (23,920)                                         | 98,347              |
| Depreciation, depletion and<br>amortization      | 49,005       | 18,940      | 24,435                             | 477                                              | 92,857              |
| Amortization of acquired sales<br>contracts, net | 10,038       |             |                                    |                                                  | 10,038              |
| Capital expenditures                             | 8,164        | 20,703      | 16,910                             | 3,848                                            | 49,625              |
| <b>Three months ended<br/>September 30, 2009</b> |              |             |                                    |                                                  |                     |
| Coal sales                                       | \$ 267,455   | \$ 148,293  | \$ 199,209                         | \$                                               | \$ 614,957          |
| Income from operations                           | 19,465       | 16,349      | 29,694                             | (17,170)                                         | 48,338              |
| Depreciation, depletion and<br>amortization      | 27,189       | 22,203      | 21,451                             | 547                                              | 71,390              |
| Amortization of acquired sales<br>contracts, net | 78           |             |                                    |                                                  | 78                  |
| Capital expenditures                             | 7,518        | 13,871      | 10,864                             | 1,218                                            | 33,471              |
| <b>Nine months ended<br/>September 30, 2010</b>  |              |             |                                    |                                                  |                     |
| Coal sales                                       | \$ 1,170,353 | \$ 402,902  | \$ 777,619                         | \$                                               | \$ 2,350,874        |
| Income from operations                           | 101,525      | 41,122      | 147,336                            | (52,937)                                         | 237,046             |
| Total assets                                     | 2,304,277    | 677,968     | 701,670                            | 1,150,871                                        | 4,834,786           |
| Depreciation, depletion and<br>amortization      | 138,059      | 57,700      | 72,190                             | 1,186                                            | 269,135             |
| Amortization of acquired sales<br>contracts, net | 26,005       |             |                                    |                                                  | 26,005              |
| Capital expenditures                             | 12,614       | 54,507      | 41,519                             | 112,943                                          | 221,583             |
| <b>Nine months ended<br/>September 30, 2009</b>  |              |             |                                    |                                                  |                     |
| Coal sales                                       | \$ 847,255   | \$ 382,931  | \$ 620,423                         | \$                                               | \$ 1,850,609        |
| Income from operations                           | 68,772       | 4,238       | 85,527                             | (64,318)                                         | 94,219              |
| Total assets                                     | 1,633,405    | 700,740     | 762,113                            | 1,697,680                                        | 4,793,938           |

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|                                               |        |        |        |         |         |
|-----------------------------------------------|--------|--------|--------|---------|---------|
| Depreciation, depletion and amortization      | 84,210 | 60,878 | 66,502 | 1,488   | 213,078 |
| Amortization of acquired sales contracts, net | 219    | (311)  |        |         | (92)    |
| Capital expenditures                          | 49,389 | 57,377 | 41,392 | 131,875 | 280,033 |

A reconciliation of segment income from operations to consolidated income before income taxes is presented below.

|                                      | <b>Three Months Ended<br/>September 30</b> |             | <b>Nine Months Ended<br/>September 30</b> |             |
|--------------------------------------|--------------------------------------------|-------------|-------------------------------------------|-------------|
|                                      | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
|                                      | <b>(In thousands)</b>                      |             |                                           |             |
| Income from operations               | \$ 98,347                                  | \$ 48,338   | \$ 237,046                                | \$ 94,219   |
| Interest expense                     | (37,698)                                   | (29,791)    | (107,906)                                 | (70,466)    |
| Interest income                      | 927                                        | 399         | 1,888                                     | 7,284       |
| Loss on early extinguishment of debt | (6,776)                                    |             | (6,776)                                   |             |
| Income before income taxes           | \$ 54,800                                  | \$ 18,946   | \$ 124,252                                | \$ 31,037   |

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**17. Supplemental Condensed Consolidating Financial Information**

Pursuant to the indenture governing the 8.75% and 7.25% senior notes, certain wholly-owned subsidiaries of the Company have fully and unconditionally guaranteed the senior notes on a joint and several basis. The following tables present unaudited condensed consolidating financial information for (i) the issuer of the notes (Arch Coal), (ii) the guarantors under the notes, and (iii) the entities which are not guarantors under the notes:

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**Condensed Consolidating Statements of Income**  
**Three Months Ended September 30, 2010**  
(in thousands)

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



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|                                                          |           |           |           |              |           |
|----------------------------------------------------------|-----------|-----------|-----------|--------------|-----------|
| Net income                                               | 46,859    | 73,265    | 35,709    | (108,974)    | 46,859    |
| Less: Net income attributable to noncontrolling interest | (181)     |           |           |              | (181)     |
| Net income attributable to Arch Coal                     | \$ 46,678 | \$ 73,265 | \$ 35,709 | \$ (108,974) | \$ 46,678 |

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**Condensed Consolidating Statements of Income**  
**Three Months Ended September 30, 2009**  
(in thousands)

|                                                                           | <b>Parent/Issuer</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---------------------------------------------------------------------------|----------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>Revenue</b>                                                            |                      |                                   |                                       |                     |                     |
| Coal Sales                                                                | \$                   | \$ 224,644                        | \$ 390,313                            | \$                  | \$ 614,957          |
| <b>Costs, expenses and other</b>                                          |                      |                                   |                                       |                     |                     |
| Cost of coal sales                                                        | 1,462                | 174,376                           | 323,972                               | (10,520)            | 489,290             |
| Depreciation, depletion and amortization                                  | 967                  | 32,122                            | 38,301                                |                     | 71,390              |
| Amortization of acquired sales contracts, net                             |                      |                                   | 78                                    |                     | 78                  |
| Selling, general and administrative expenses                              | 10,613               | 1,719                             | 13,109                                | (1,412)             | 24,029              |
| Change in fair value of coal derivatives and coal trading activities, net |                      | (3,342)                           |                                       |                     | (3,342)             |
| Costs related to acquisition of Jacobs Ranch                              | 791                  |                                   |                                       |                     | 791                 |
| Other operating expense (income), net                                     | (6,421)              | (24,171)                          | 3,043                                 | 11,932              | (15,617)            |
|                                                                           | 7,412                | 180,704                           | 378,503                               |                     | 566,619             |
| Income from investment in subsidiaries                                    | 50,455               |                                   |                                       | (50,455)            |                     |
| Income from operations                                                    | 43,043               | 43,940                            | 11,810                                | (50,455)            | 48,338              |
| Interest expense, net:                                                    |                      |                                   |                                       |                     |                     |
| Interest expense                                                          | (25,526)             | (746)                             | (17,253)                              | 13,734              | (29,791)            |
| Interest income                                                           | 1,429                | 144                               | 12,560                                | (13,734)            | 399                 |
|                                                                           | (24,097)             | (602)                             | (4,693)                               |                     | (29,392)            |
| Income before income taxes                                                | 18,946               | 43,338                            | 7,117                                 | (50,455)            | 18,946              |
| Benefit from income taxes                                                 | (6,270)              |                                   |                                       |                     | (6,270)             |
| Net income                                                                | 25,216               | 43,338                            | 7,117                                 | (50,455)            | 25,216              |
| Less: Net income attributable to noncontrolling interest                  | (31)                 |                                   |                                       |                     | (31)                |

|                                      |    |        |    |        |    |       |    |          |    |        |
|--------------------------------------|----|--------|----|--------|----|-------|----|----------|----|--------|
| Net income attributable to Arch Coal | \$ | 25,185 | \$ | 43,338 | \$ | 7,117 | \$ | (50,455) | \$ | 25,185 |
|--------------------------------------|----|--------|----|--------|----|-------|----|----------|----|--------|

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**Condensed Consolidating Statements of Income**  
**Nine Months Ended September 30, 2010**  
(in thousands)

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

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|                                                          |            |            |           |              |            |         |
|----------------------------------------------------------|------------|------------|-----------|--------------|------------|---------|
| Provision for income taxes                               | 12,889     |            |           |              |            | 12,889  |
| Net income                                               | 111,363    | 217,689    | 65,105    | (282,794)    |            | 111,363 |
| Less: Net income attributable to noncontrolling interest | (325)      |            |           |              |            | (325)   |
| Net income attributable to Arch Coal                     | \$ 111,038 | \$ 217,689 | \$ 65,105 | \$ (282,794) | \$ 111,038 |         |

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**Condensed Consolidating Statements of Income**  
**Nine Months Ended September 30, 2009**  
(in thousands)

|                                                                           | <b>Parent/Issuer</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---------------------------------------------------------------------------|----------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>Revenue</b>                                                            |                      |                                   |                                       |                     |                     |
| Coal Sales                                                                | \$                   | \$ 683,240                        | \$ 1,167,369                          | \$                  | \$ 1,850,609        |
| <b>Costs, expenses and other</b>                                          |                      |                                   |                                       |                     |                     |
| Cost of coal sales                                                        | 2,957                | 527,647                           | 1,005,640                             | (32,307)            | 1,503,937           |
| Depreciation, depletion and amortization                                  | 2,725                | 97,255                            | 113,098                               |                     | 213,078             |
| Amortization of acquired sales contracts, net                             |                      |                                   | (92)                                  |                     | (92)                |
| Selling, general and administrative expenses                              | 38,245               | 5,523                             | 31,262                                | (4,260)             | 70,770              |
| Change in fair value of coal derivatives and coal trading activities, net |                      | (10,328)                          |                                       |                     | (10,328)            |
| Costs related to acquisition of Jacobs Ranch                              | 7,166                |                                   |                                       |                     | 7,166               |
| Other operating (income) expense, net                                     | (8,318)              | (60,185)                          | 3,795                                 | 36,567              | (28,141)            |
|                                                                           | 42,775               | 559,912                           | 1,153,703                             |                     | 1,756,390           |
| Income from investment in subsidiaries                                    | 122,025              |                                   |                                       | (122,025)           |                     |
| Income from operations                                                    | 79,250               | 123,328                           | 13,666                                | (122,025)           | 94,219              |
| Interest expense, net:                                                    |                      |                                   |                                       |                     |                     |
| Interest expense                                                          | (60,561)             | (1,951)                           | (52,577)                              | 44,623              | (70,466)            |
| Interest income                                                           | 12,348               | 654                               | 38,905                                | (44,623)            | 7,284               |
|                                                                           | (48,213)             | (1,297)                           | (13,672)                              |                     | (63,182)            |
| Income (loss) before income taxes                                         | 31,037               | 122,031                           | (6)                                   | (122,025)           | 31,037              |
| Benefit from income taxes                                                 | (9,590)              |                                   |                                       |                     | (9,590)             |
| Net income (loss)                                                         | 40,627               | 122,031                           | (6)                                   | (122,025)           | 40,627              |
| Less: Net loss attributable to noncontrolling interest                    | 11                   |                                   |                                       |                     | 11                  |

|                                             |    |        |    |         |    |     |    |           |    |        |
|---------------------------------------------|----|--------|----|---------|----|-----|----|-----------|----|--------|
| Net income (loss) attributable to Arch Coal | \$ | 40,638 | \$ | 122,031 | \$ | (6) | \$ | (122,025) | \$ | 40,638 |
|---------------------------------------------|----|--------|----|---------|----|-----|----|-----------|----|--------|

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**Condensed Consolidating Balance Sheets**  
**September 30, 2010**  
(in thousands)

|                                                      | <b>Parent/Issuer</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|------------------------------------------------------|----------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>Assets</b>                                        |                      |                                   |                                       |                     |                     |
| Cash and cash equivalents                            | \$ 1,790             | \$ 52                             | \$ 61,911                             | \$                  | \$ 63,753           |
| Receivables                                          | 31,181               | 13,124                            | 250,858                               | (384)               | 294,779             |
| Inventories                                          |                      | 78,081                            | 140,877                               |                     | 218,958             |
| Other                                                | 58,132               | 110,652                           | 17,150                                |                     | 185,934             |
| Total current assets                                 | 91,103               | 201,909                           | 470,796                               | (384)               | 763,424             |
| Property, plant and equipment, net                   | 9,583                | 1,795,993                         | 1,497,452                             |                     | 3,303,028           |
| Investment in subsidiaries                           | 4,429,088            |                                   |                                       | (4,429,088)         |                     |
| Intercompany receivables                             | (1,755,561)          | 470,943                           | 1,284,618                             |                     |                     |
| Other                                                | 661,403              | 320,423                           | 11,508                                | (225,000)           | 768,334             |
| Total other assets                                   | 3,334,930            | 791,366                           | 1,296,126                             | (4,654,088)         | 768,334             |
| Total assets                                         | \$ 3,435,616         | \$ 2,789,268                      | \$ 3,264,374                          | \$ (4,654,472)      | \$ 4,834,786        |
| <b>Liabilities and Stockholders Equity</b>           |                      |                                   |                                       |                     |                     |
| Accounts payable                                     | \$ 9,317             | \$ 64,478                         | \$ 98,486                             | \$                  | \$ 172,281          |
| Accrued expenses and other current liabilities       | 43,119               | 34,543                            | 129,311                               | (384)               | 206,589             |
| Current maturities of debt and short-term borrowings | 4,218                |                                   | 135,116                               |                     | 139,334             |
| Total current liabilities                            | 56,654               | 99,021                            | 362,913                               | (384)               | 518,204             |
| Long-term debt                                       | 1,086,690            |                                   | 676,780                               | (225,000)           | 1,538,470           |
| Asset retirement obligations                         | 579                  | 30,690                            | 291,756                               |                     | 323,025             |
| Accrued pension benefits                             | 23,837               | 4,562                             | 35,746                                |                     | 64,145              |
| Accrued postretirement benefits other than pension   | 16,136               |                                   | 29,473                                |                     | 45,609              |
| Accrued workers compensation                         | 10,709               | 13,669                            | 3,848                                 |                     | 28,226              |
| Other noncurrent liabilities                         | 43,962               | 23,706                            | 52,390                                |                     | 120,058             |
| Total liabilities                                    | 1,238,567            | 171,648                           | 1,452,906                             | (225,384)           | 2,637,737           |
| Redeemable noncontrolling interest                   | 10,173               |                                   |                                       |                     | 10,173              |
| Stockholders equity                                  | 2,186,876            | 2,617,620                         | 1,811,468                             | (4,429,088)         | 2,186,876           |



|                                               |              |              |              |                |              |
|-----------------------------------------------|--------------|--------------|--------------|----------------|--------------|
| Total liabilities and<br>stockholders' equity | \$ 3,435,616 | \$ 2,789,268 | \$ 3,264,374 | \$ (4,654,472) | \$ 4,834,786 |
|-----------------------------------------------|--------------|--------------|--------------|----------------|--------------|

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**Condensed Consolidating Balance Sheets**  
**December 31, 2009**  
(in thousands)

|                                                      | <b>Parent/Issuer</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|------------------------------------------------------|----------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>Assets</b>                                        |                      |                                   |                                       |                     |                     |
| Cash and cash equivalents                            | \$ 54,255            | \$ 64                             | \$ 6,819                              | \$                  | \$ 61,138           |
| Receivables                                          | 16,339               | 15,574                            | 199,457                               |                     | 231,370             |
| Inventories                                          |                      | 75,126                            | 165,650                               |                     | 240,776             |
| Other                                                | 28,741               | 101,407                           | 23,350                                |                     | 153,498             |
| Total current assets                                 | 99,335               | 192,171                           | 395,276                               |                     | 686,782             |
| Property, plant and equipment, net                   | 7,783                | 1,809,340                         | 1,549,063                             |                     | 3,366,186           |
| Investment in subsidiaries                           | 4,127,075            |                                   |                                       | (4,127,075)         |                     |
| Intercompany receivables                             | (1,679,003)          | 232,076                           | 1,446,927                             |                     |                     |
| Other                                                | 455,972              | 317,486                           | 14,170                                |                     | 787,628             |
| Total other assets                                   | 2,904,044            | 549,562                           | 1,461,097                             | (4,127,075)         | 787,628             |
| Total assets                                         | \$ 3,011,162         | \$ 2,551,073                      | \$ 3,405,436                          | \$ (4,127,075)      | \$ 4,840,596        |
| <b>Liabilities and Stockholders Equity</b>           |                      |                                   |                                       |                     |                     |
| Accounts payable                                     | \$ 12,828            | \$ 41,066                         | \$ 74,508                             | \$                  | \$ 128,402          |
| Accrued expenses and other current liabilities       | 54,957               | 36,394                            | 144,510                               |                     | 235,861             |
| Current maturities of debt and short-term borrowings | 134,012              |                                   | 133,452                               |                     | 267,464             |
| Total current liabilities                            | 201,797              | 77,460                            | 352,470                               |                     | 631,727             |
| Long-term debt                                       | 585,441              |                                   | 954,782                               |                     | 1,540,223           |
| Asset retirement obligations                         | 927                  | 29,253                            | 274,914                               |                     | 305,094             |
| Accrued pension benefits                             | 29,001               | 4,742                             | 34,523                                |                     | 68,266              |
| Accrued postretirement benefits other than pension   | 15,046               |                                   | 28,819                                |                     | 43,865              |
| Accrued workers compensation                         | 10,595               | 14,448                            | 4,067                                 |                     | 29,110              |
| Other noncurrent liabilities                         | 44,287               | 27,213                            | 26,743                                |                     | 98,243              |
| Total liabilities                                    | 887,094              | 153,116                           | 1,676,318                             |                     | 2,716,528           |
| Redeemable noncontrolling interest                   | 8,962                |                                   |                                       |                     | 8,962               |
| Stockholders equity                                  | 2,115,106            | 2,397,957                         | 1,729,118                             | (4,127,075)         | 2,115,106           |

|                                               |              |              |              |                |              |
|-----------------------------------------------|--------------|--------------|--------------|----------------|--------------|
| Total liabilities and<br>stockholders' equity | \$ 3,011,162 | \$ 2,551,073 | \$ 3,405,436 | \$ (4,127,075) | \$ 4,840,596 |
|-----------------------------------------------|--------------|--------------|--------------|----------------|--------------|

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**Condensed Consolidating Statements of Cash Flows**  
**Nine Months Ended September 30, 2010**  
(in thousands)

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

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**Condensed Consolidating Statements of Cash Flows**  
**Nine Months Ended September 30, 2009**  
(in thousands)

|                                                                                          | <b>Parent/Issuer</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Consolidated</b> |
|------------------------------------------------------------------------------------------|----------------------|-----------------------------------|---------------------------------------|---------------------|
| Cash provided by (used in) operating activities                                          | \$ (120,471)         | \$ 198,300                        | \$ 168,614                            | \$ 246,443          |
| Investing Activities                                                                     |                      |                                   |                                       |                     |
| Capital expenditures                                                                     | (2,450)              | (170,818)                         | (106,765)                             | (280,033)           |
| Proceeds from dispositions of property, plant and equipment                              |                      | 776                               | 30                                    | 806                 |
| Purchases of investments and advances to affiliates                                      | (8,000)              | (2,353)                           |                                       | (10,353)            |
| Additions to prepaid royalties                                                           |                      | (20,465)                          | (2,409)                               | (22,874)            |
| Reimbursement of deposits on equipment                                                   |                      |                                   | 3,209                                 | 3,209               |
| Cash used in investing activities                                                        | (10,450)             | (192,860)                         | (105,935)                             | (309,245)           |
| Financing Activities                                                                     |                      |                                   |                                       |                     |
| Proceeds from the issuance of long-term debt                                             | 584,784              |                                   |                                       | 584,784             |
| Proceeds from the sale of common stock                                                   | 326,452              |                                   |                                       | 326,452             |
| Net increase (decrease) in borrowings under lines of credit and commercial paper program | 95,000               |                                   | (90,655)                              | 4,345               |
| Net payments on other debt                                                               | (13,276)             |                                   |                                       | (13,276)            |
| Debt financing costs                                                                     | (29,456)             |                                   | (140)                                 | (29,596)            |
| Dividends paid                                                                           | (40,347)             |                                   |                                       | (40,347)            |
| Issuance of common stock under incentive plans                                           | 84                   |                                   |                                       | 84                  |
| Transactions with affiliates, net                                                        | (23,070)             | (5,437)                           | 28,507                                |                     |
| Cash provided by (used in) financing activities                                          | 900,171              | (5,437)                           | (62,288)                              | 832,446             |
| Increase in cash and cash equivalents                                                    | 769,250              | 3                                 | 391                                   | 769,644             |
| Cash and cash equivalents, beginning of period                                           | 67,737               | 61                                | 2,851                                 | 70,649              |
| Cash and cash equivalents, end of period                                                 | \$ 836,987           | \$ 64                             | \$ 3,242                              | \$ 840,293          |

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

*This document contains forward-looking statements that is, statements related to future, not past, events. In this context, forward-looking statements often address our expected future business and financial performance, and often contain words such as expects, anticipates, intends, plans, believes, seeks, or will. Forward-looking statements by their nature address matters that are, to different degrees, uncertain. For us, particular uncertainties arise from changes in the demand for our coal by the domestic electric generation industry; from legislation and regulations relating to the Clean Air Act and other environmental initiatives; from regulations relating to mine safety; from operational, geological, permit, labor and weather-related factors; from fluctuations in the amount of cash we generate from operations; from future integration of acquired businesses; and from numerous other matters of national, regional and global scale, including those of a political, economic, business, competitive or regulatory nature. These uncertainties may cause our actual future results to be materially different than those expressed in our forward-looking statements. We do not undertake to update our forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by law. For a description of some of the risks and uncertainties that may affect our future results, see Risk Factors under Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2009 and under Item 1A of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010.*

**Overview**

We are one of the largest coal producers in the United States. We sell substantially all of our coal to power plants, steel mills and industrial facilities. The locations of our mines enable us to ship coal to most of the major coal-fueled power plants, steel mills and export facilities located in the United States. We also export coal, particularly the metallurgical coal that is used in the steel industry, but, increasingly, steam coal as well.

Our three reportable business segments are based on the low-sulfur U.S. coal producing regions in which we operate the Powder River Basin, the Western Bituminous region and the Central Appalachia region. These geographically distinct areas are characterized by geology, coal transportation routes to consumers, regulatory environments and coal quality. These regional similarities have caused market and contract pricing environments to develop by coal region and form the basis for the segmentation of our operations.

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

Growth in domestic and global coal demand combined with declining domestic coal production have positively impacted coal markets during 2010. Year-to-date U.S. power generation increased approximately 4% through the third week of October, in response to improving economic conditions, as well as favorable weather trends across most regions of the U.S. We estimate that U.S. steam coal consumption grew by 6.5% through September 2010, driven by the increase in power generation as well as improving industrial demand. Growth in global coal demand has also positively influenced the U.S. coal markets. After a slowing of the metallurgical coal markets earlier in the third quarter, the markets appear to have rebounded, and Chinese met coal imports increased in September. We expect that 2010 U.S. coal exports will improve over 2009 levels, linked primarily to increased demand for metallurgical coal.

Conversely, U.S. coal production has declined more than 6 million tons through the first nine months of 2010, according to data released by MSHA, including a 12 million ton decline in Central Appalachia. We expect the Central Appalachia supply pressures to create growth potential for other coal basins, particularly the Powder River Basin. Coal production in the Powder River Basin increased 2 million tons through September 30, 2010, and forward prices for Powder River Basin coal have improved since the beginning of the year.

**Table of Contents****Items Affecting Comparability of Reported Results**

We temporarily suspended production at our Dugout Canyon mine in Carbon County, Utah, on April 29, 2010 after an increase in carbon monoxide levels resulted from a heating event in a previously mined area. After permanently sealing the area, we resumed full coal production on May 21, 2010. On June 22, 2010, an ignition event at our longwall resulted in a second evacuation of all underground employees at the mine. All employees were safely evacuated in both events. The resumption of mining required us to render the mine's atmosphere inert, ventilate the longwall area, determine the cause of the ignition, implement preventive measures, and secure an MSHA-approved longwall ventilation plan. We restarted the longwall system on September 9, 2010, and resumed production at normalized levels by the end of September. As a result of the outages in the second and third quarters, the Dugout Canyon mine incurred a loss of \$10.4 million for the three months ended September 30, 2010, and \$28.9 million for the nine months ended September 30, 2010. We have provided additional information about the performance of our operating segments under the heading *Operating segment results*.

In the second quarter of 2010, we exchanged 68.4 million tons of coal reserves in the Illinois Basin for an additional 9% ownership interest in Knight Hawk Holdings, LLC (Knight Hawk), increasing our ownership to 42%. We recognized a pre-tax gain of \$41.6 million on the transaction, representing the difference between the fair value and net book value of the coal reserves, adjusted for our retained ownership interest in the reserves through the investment in Knight Hawk.

On August 9, 2010, we issued \$500.0 million in aggregate principal amount of 7.25% senior unsecured notes due in 2020 at par. We used the net proceeds from the offering and cash on hand to fund the redemption on September 8, 2010 of \$500.0 million aggregate principal amount of our outstanding 6.75% senior notes due in 2013 at a redemption price of 101.125%. We recognized a loss on the redemption of \$6.8 million, including the payment of the \$5.6 million redemption premium, the write-off of \$3.3 million of unamortized debt financing costs, partially offset by the write-off of \$2.1 million of the original issue premium on the 6.75% senior notes.

**Results of Operations*****Three Months Ended September 30, 2010 Compared to Three Months Ended September 30, 2009***

*Summary.* Our improved results during the third quarter of 2010, when compared to the third quarter of 2009, were primarily generated from increased sales volumes, including an increase in metallurgical coal volumes sold. Higher interest and other financing costs partially offset the benefit from these factors, as did a decrease in revenues from other operating sources.

*Revenues.* The following table summarizes information about coal sales for the three months ended September 30, 2010 and compares it with the information for the three months ended September 30, 2009:

|                                     | <b>Three Months Ended<br/>September 30</b>                         |             | <b>Increase (Decrease)<br/>in Net Income</b> |          |
|-------------------------------------|--------------------------------------------------------------------|-------------|----------------------------------------------|----------|
|                                     | <b>2010</b>                                                        | <b>2009</b> | <b>Amount</b>                                | <b>%</b> |
|                                     | <b>(Amounts in thousands, except per ton data and percentages)</b> |             |                                              |          |
| Coal sales                          | \$874,705                                                          | \$614,957   | \$259,748                                    | 42.2%    |
| Tons sold                           | 44,173                                                             | 29,338      | 14,835                                       | 50.6%    |
| Coal sales realization per ton sold | \$ 19.80                                                           | \$ 20.96    | \$ (1.16)                                    | (5.5)%   |

Coal sales increased in the third quarter of 2010 from the third quarter of 2009 due to an increase in tons sold in the Powder River Basin and Central Appalachia regions. Our coal sales realizations per ton were lower in the 2010 quarter as the impact on our average selling price of the increased Powder River Basin volumes offset the benefit from an increase in metallurgical coal sales volumes. We have provided more information about the tons sold and the coal sales realizations per ton by operating segment under the heading *Operating segment results*.

*Costs, expenses and other.* The following table summarizes costs, expenses and other components of operating income for the three months ended September 30, 2010 and compares them with the information for the three months ended September 30, 2009:



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|                                                                           | <b>Three Months Ended</b>                         |             | <b>Increase (Decrease)</b> |          |
|---------------------------------------------------------------------------|---------------------------------------------------|-------------|----------------------------|----------|
|                                                                           | <b>September 30</b>                               |             | <b>in Net Income</b>       |          |
|                                                                           | <b>2010</b>                                       | <b>2009</b> | <b>\$</b>                  | <b>%</b> |
|                                                                           | <b>(Amounts in thousands, except percentages)</b> |             |                            |          |
| Cost of coal sales                                                        | \$ 651,853                                        | \$ 489,290  | \$ (162,563)               | (33.2)%  |
| Depreciation, depletion and amortization                                  | 92,857                                            | 71,390      | (21,467)                   | (30.1)   |
| Amortization of acquired sales contracts, net                             | 10,038                                            | 78          | (9,960)                    | N/A      |
| Selling, general and administrative expenses                              | 26,999                                            | 24,029      | (2,970)                    | (12.4)   |
| Change in fair value of coal derivatives and coal trading activities, net | 1,832                                             | (3,342)     | (5,174)                    | (154.8)  |
| Costs related to acquisition of Jacobs Ranch                              |                                                   | 791         | 791                        | 100.0    |
| Other operating income, net                                               | (7,221)                                           | (15,617)    | (8,396)                    | (53.8)   |
|                                                                           | \$ 776,358                                        | \$ 566,619  | \$ (209,739)               | (37.0)%  |

*Cost of coal sales.* Our cost of coal sales increased in the third quarter of 2010 from the third quarter of 2009 primarily due to the higher sales volumes discussed above, partially offset by a lower average cost per ton sold, resulting from the impact of the increased Powder River Basin volumes, as well as lower per-ton production costs in the Powder River Basin. We have provided more information about our operating segments under the heading

*Operating segment results* .

*Depreciation, depletion and amortization and amortization of acquired sales contracts, net.* When compared with the third quarter of 2009, higher depreciation and amortization costs in the third quarter of 2010 resulted primarily from the impact of the acquisition of the Jacobs Ranch mining complex in the fourth quarter of 2009.

*Selling, general and administrative expenses.* The increase in selling, general and administrative expenses from the third quarter of 2009 to the third quarter of 2010 is due primarily to compensation-related costs. In particular, our improved results resulted in higher costs of \$2.5 million in 2010 related to our incentive compensation plans when compared to 2009.

*Change in fair value of coal derivatives and coal trading activities, net.* Net (gains) losses relate to the net impact of our coal trading activities and the change in fair value of other coal derivatives that have not been designated as hedge instruments in a hedging relationship. During the third quarter of 2010, rising coal prices resulted in losses on derivative positions and trading activities, compared with weaker market conditions in the third quarter of 2009, which resulted in gains.

*Other operating income, net.* The decrease in net other operating income from the third quarter of 2009 is primarily the result of a decrease in income from contract settlements and bookout transactions, partially offset by an increase in income from our investment in Knight Hawk of \$1.9 million.

*Operating segment results.* The following table shows results by operating segment for the three months ended September 30, 2010 and compares it with information for the three months ended September 30, 2009:

|                                                    | <b>Three Months Ended</b> |             | <b>Increase (Decrease)</b> |          |
|----------------------------------------------------|---------------------------|-------------|----------------------------|----------|
|                                                    | <b>September 30</b>       |             |                            |          |
|                                                    | <b>2010</b>               | <b>2009</b> | <b>\$</b>                  | <b>%</b> |
| <i>Powder River Basin</i>                          |                           |             |                            |          |
| Tons sold (in thousands)                           | 36,129                    | 21,528      | 14,601                     | 67.8%    |
| Coal sales realization per ton sold <sup>(1)</sup> | \$ 12.12                  | \$ 12.26    | \$ (0.14)                  | (1.1)%   |
| Operating margin per ton sold <sup>(2)</sup>       | \$ 1.41                   | \$ 0.95     | \$ 0.46                    | 48.4%    |

*Western Bituminous*

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|                                                    |          |          |         |         |
|----------------------------------------------------|----------|----------|---------|---------|
| Tons sold (in thousands)                           | 4,024    | 4,560    | (536)   | (11.8)% |
| Coal sales realization per ton sold <sup>(1)</sup> | \$ 30.66 | \$ 29.08 | \$ 1.58 | 5.4%    |
| Operating margin per ton sold <sup>(2)</sup>       | \$ 3.61  | \$ 3.51  | \$ 0.10 | 2.8%    |

*Central Appalachia*

|                                                    |          |          |         |        |
|----------------------------------------------------|----------|----------|---------|--------|
| Tons sold (in thousands)                           | 4,020    | 3,250    | 770     | 23.7%  |
| Coal sales realization per ton sold <sup>(1)</sup> | \$ 69.29 | \$ 59.77 | \$ 9.52 | 15.9%  |
| Operating margin per ton sold <sup>(2)</sup>       | \$ 13.34 | \$ 5.47  | \$ 7.87 | 143.9% |

<sup>(1)</sup> Coal sales prices per ton exclude certain transportation costs that we pass through to our customers. We use these financial measures because we believe the amounts as adjusted better represent the coal sales prices we achieved within our operating segments. Since other companies may calculate coal sales prices per ton differently, our calculation may not be comparable to similarly titled measures used by those companies. For the three months ended September 30, 2010, transportation costs per ton were \$0.07 for the Powder River Basin, \$3.64 for the Western Bituminous region and \$4.40 for Central Appalachia. For the three months ended September 30, 2009, transportation costs per ton were \$0.17 for the Powder River Basin, \$3.44 for the Western Bituminous region and \$1.52 for Central Appalachia.

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

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**Powder River Basin** The increase in sales volume in the Powder River Basin in the third quarter of 2010 when compared with the third quarter of 2009 resulted primarily from the acquisition of the Jacobs Ranch mining operations on October 1, 2009, although improving demand for Powder River Basin coal also had an impact on sales volumes. Sales prices decreased during the third quarter of 2010 when compared with the third quarter of 2009 primarily reflecting the roll-off of contracts committed when market conditions were more favorable, as well as the effect of lower sulphur dioxide emission allowance pricing. On a per-ton basis, operating margins in the third quarter of 2010 increased from the third quarter of 2009 due to a decrease in per-ton costs, which offset the impact of the lower per-ton sales prices. The decrease in per-ton costs resulted primarily from efficiencies achieved from combining the acquired Jacobs Ranch mining operations with our existing Black Thunder operations, increased base production volumes and a decrease in hedged diesel fuel costs.

**Western Bituminous** In the Western Bituminous region, sales volumes in the third quarter of 2010 decreased when compared to the depressed sales volume levels in the third quarter of 2009 due primarily to the production outage at the Dugout Canyon mine for a substantial part of the quarter. Sales volumes in the third quarter of 2009 were affected by weaker market conditions that had an impact on our ability to market coal with a high ash content, which resulted from geologic conditions at our West Elk mine, and the decision to reduce production accordingly. We have recently completed construction of a preparation plant at the West Elk mine to address quality issues that could result from sandstone intrusions similar to those we encountered previously. Despite the detrimental impact in 2009 on our per-ton realizations of selling coal with a higher ash content, our realizations improved only slightly in 2010, due to ongoing soft steam coal market conditions in the region. Slightly higher per-ton operating margins in the third quarter of 2010 were the result of the higher realizations but were mostly offset by the impact of the production outage at the Dugout Canyon mine.

**Central Appalachia** The increase in sales volumes in the third quarter of 2010, when compared with the third quarter of 2009, was due to the improvement in the metallurgical coal markets. We sold 1.4 million tons into metallurgical markets in the third quarter of 2010 compared to 0.5 million tons in the third quarter of 2009. Because metallurgical coal generally commands a higher price than steam coal, the increase had a favorable impact on our average realizations, as did the higher pricing on metallurgical tons sold, compared to the third quarter of 2009. The benefit from higher per-ton realizations drove the substantial improvement in our operating margins over the third quarter of 2009, partially offset by slightly higher production and sales-sensitive costs.

**Net interest expense.** The following table summarizes our net interest expense for the three months ended September 30, 2010 and compares it with the information for the three months ended September 30, 2009:

|                  | Increase (Decrease) in Net                 |             |            |         |
|------------------|--------------------------------------------|-------------|------------|---------|
|                  | Three Months Ended                         |             | Income     |         |
|                  | 2010                                       | 2009        | \$         | %       |
|                  | (Amounts in thousands, except percentages) |             |            |         |
| Interest expense | \$ (37,698)                                | \$ (29,791) | \$ (7,907) | (26.5)% |
| Interest income  | 927                                        | 399         | 528        | 132.3%  |
|                  | \$ (36,771)                                | \$ (29,392) | \$ (7,379) | (25.1)% |

The increase in net interest expense in the third quarter of 2010 compared to the third quarter of 2009 is primarily due to an increase in average debt outstanding due to the issuance of the 8.75% senior notes in the third quarter of 2009 to finance the acquisition of the Jacobs Ranch mining complex and the issuance of the 7.25% senior notes on August 9, 2010. The proceeds from the issuance 7.25% senior notes were used to redeem a portion of the 6.75% senior notes on September 8, 2010.

**Other non-operating expense.** The following table summarizes our other non-operating expense for the three months ended September 30, 2010 and compares it with the information for the three months ended September 30,

2009:

|                                      | Three Months Ended                         |      | Decrease in Net Income |     |
|--------------------------------------|--------------------------------------------|------|------------------------|-----|
|                                      | September 30<br>2010                       | 2009 | \$                     | %   |
|                                      | (Amounts in thousands, except percentages) |      |                        |     |
| Loss on early extinguishment of debt | \$(6,776)                                  | \$   | \$(6,776)              | N/A |

Amounts reported as non-operating consist of income or expense resulting from our financing activities, other than interest costs. The loss on early extinguishment of debt relates to the redemption of \$500 million in principal amount of the 6.75% senior notes. The loss includes the payment of \$5.6 million of redemption premium and the write-off of \$3.3 million of unamortized debt financing costs, partially offset by the write-off of \$2.1 million of the original issue premium.

*Income taxes.* Our effective income tax rate is sensitive to changes in estimates of annual profitability and the

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deduction for percentage depletion. The following table summarizes our income taxes for the three months ended September 30, 2010 and compares it with information for the three months ended September 30, 2009:

|                                                   | <b>Three Months Ended<br/>September 30</b> |             | <b>Decrease in Net Income</b> |          |
|---------------------------------------------------|--------------------------------------------|-------------|-------------------------------|----------|
|                                                   | <b>2010</b>                                | <b>2009</b> | <b>\$</b>                     | <b>%</b> |
| <b>(Amounts in thousands, except percentages)</b> |                                            |             |                               |          |
| Provision for (benefit from) income taxes         | \$7,941                                    | \$(6,270)   | \$(14,211)                    | (226.7)% |

**Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2009**

*Summary.* Our improved results during the nine months ended September 30, 2010 when compared to the nine months ended September 30, 2009, were generated from increased sales volumes, including an increase in metallurgical coal volumes sold, lower production costs and the gain on the Knight Hawk transaction. Higher selling, general and administrative costs, unrealized losses on coal derivatives and higher interest and financing costs partially offset the benefit from these factors.

*Revenues.* The following table summarizes information about coal sales for the nine months ended September 30, 2010 and compares it with the information for the nine months ended September 30, 2009:

|                                                                    | <b>Nine Months Ended September<br/>30</b> |             | <b>Increase (Decrease)<br/>in Net Income</b> |          |
|--------------------------------------------------------------------|-------------------------------------------|-------------|----------------------------------------------|----------|
|                                                                    | <b>2010</b>                               | <b>2009</b> | <b>Amount</b>                                | <b>%</b> |
| <b>(Amounts in thousands, except per ton data and percentages)</b> |                                           |             |                                              |          |
| Coal sales                                                         | \$2,350,874                               | \$1,850,609 | \$500,265                                    | 27.0%    |
| Tons sold                                                          | 120,319                                   | 87,888      | 32,431                                       | 36.9%    |
| Coal sales realization per ton sold                                | \$ 19.54                                  | \$ 21.06    | \$ (1.52)                                    | (7.2)%   |

Coal sales increased in 2010 from 2009, primarily due to an increase in tons sold in the Powder River Basin region, resulting from the acquisition of the Jacobs Ranch mining complex in the fourth quarter of 2009, as well as an increase in regional demand in the third quarter of 2010. Our coal sales realizations per ton were lower in 2010 as lower pricing in the Powder River Basin and the impact on our average selling price of the higher Powder River Basin volumes offset the benefit of an increase in metallurgical coal sales volumes. We have provided more information about the tons sold and the coal sales realizations per ton by operating segment under the heading Operating segment results .

*Costs, expenses and other.* The following table summarizes costs, expenses and other components of operating income for the nine months ended September 30, 2010 and compares them with the information for the nine months ended September 30, 2009:

|                                                                           | <b>Nine Months Ended<br/>September 30</b> |              | <b>Increase (Decrease)<br/>in Net Income</b> |          |
|---------------------------------------------------------------------------|-------------------------------------------|--------------|----------------------------------------------|----------|
|                                                                           | <b>2010</b>                               | <b>2009</b>  | <b>\$</b>                                    | <b>%</b> |
| <b>(Amounts in thousands, except percentages)</b>                         |                                           |              |                                              |          |
| Cost of coal sales                                                        | \$ 1,773,464                              | \$ 1,503,937 | \$(269,527)                                  | (17.9)%  |
| Depreciation, depletion and amortization                                  | 269,135                                   | 213,078      | (56,057)                                     | (26.3)%  |
| Amortization of acquired sales contracts, net                             | 26,005                                    | (92)         | (26,097)                                     | N/A      |
| Selling, general and administrative expenses                              | 89,509                                    | 70,770       | (18,739)                                     | (26.5)%  |
| Change in fair value of coal derivatives and coal trading activities, net | 12,296                                    | (10,328)     | (22,624)                                     | (219.1)% |
| Gain on Knight Hawk transaction                                           | (41,577)                                  |              | 41,577                                       | N/A      |
| Costs related to acquisition of Jacobs Ranch                              |                                           | 7,166        | 7,166                                        | 100.0%   |

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|                             |              |              |              |         |
|-----------------------------|--------------|--------------|--------------|---------|
| Other operating income, net | (15,004)     | (28,141)     | (13,137)     | (46.7)% |
|                             | \$ 2,113,828 | \$ 1,756,390 | \$ (357,438) | (20.4)% |

*Cost of coal sales.* Our cost of coal sales increased in 2010 from 2009 primarily due to the higher sales volumes discussed above, partially offset by the impact of a lower average cost per-ton sold, due to the impact of the increased Powder River Basin volumes as well as lower per-ton production costs in our Western regions. We have provided more information about our operating segments under the heading Operating segment results .

*Depreciation, depletion and amortization and amortization of acquired sales contracts, net.* When compared with 2009, higher depreciation and amortization costs in 2010 resulted primarily from the impact of the acquisition of the Jacobs Ranch mining complex in the fourth quarter of 2009.

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*Selling, general and administrative expenses.* The increase in selling, general and administrative expenses in 2010 is due primarily to compensation-related costs and a contribution to the Arch Coal Foundation of \$5.0 million in 2010. In particular, our improved results were the primary driver of higher costs of approximately \$7.5 million in 2010 related to our incentive compensation plans when compared to 2009. Costs related to our deferred compensation plan, where amounts recognized are impacted by changes in the value of our common stock and changes in the value of the underlying investments, also increased \$3.9 million.

*Change in fair value of coal derivatives and coal trading activities, net.* Net (gains) losses relate to the net impact of our coal trading activities and the change in fair value of other coal derivatives that have not been designated as hedge instruments in a hedging relationship. During 2010, rising coal prices resulted in losses on derivative positions and trading activities, compared with weaker market conditions in 2009, which resulted in gains.

*Gain on Knight Hawk Transaction.* The gain was recognized on our exchange of Illinois Basin reserves for an additional ownership interest in Knight Hawk, an equity method investee operating in the Illinois Basin.

*Other operating income, net.* The decrease in net other operating income in 2010 from 2009 is primarily the result of a decrease in income from contract settlements and bookout transactions of \$16.1 million, a decrease in income from outlease royalties of \$1.4 million and a decrease in transloading fees of \$1.0 million, partially offset by an increase in income from our investment in Knight Hawk of \$4.3 million.

*Operating segment results.* The following table shows results by operating segment for the nine months ended September 30, 2010 and compares it with information for the nine months ended September 30, 2009:

|                                                    | <b>Nine Months Ended</b> |             | <b>Increase (Decrease)</b> |          |
|----------------------------------------------------|--------------------------|-------------|----------------------------|----------|
|                                                    | <b>September 30</b>      |             |                            |          |
|                                                    | <b>2010</b>              | <b>2009</b> | <b>\$</b>                  | <b>%</b> |
| <i>Powder River Basin</i>                          |                          |             |                            |          |
| Tons sold (in thousands)                           | 97,725                   | 65,964      | 31,761                     | 48.1%    |
| Coal sales realization per ton sold <sup>(3)</sup> | \$ 11.90                 | \$ 12.70    | \$ (0.80)                  | (6.3)%   |
| Operating margin per ton sold <sup>(4)</sup>       | \$ 1.02                  | \$ 1.00     | \$ 0.02                    | 2.0%     |
| <i>Western Bituminous</i>                          |                          |             |                            |          |
| Tons sold (in thousands)                           | 12,149                   | 11,987      | 162                        | 1.4%     |
| Coal sales realization per ton sold <sup>(3)</sup> | \$ 29.90                 | \$ 29.00    | \$ 0.90                    | 3.1%     |
| Operating margin per ton sold <sup>(4)</sup>       | \$ 3.10                  | \$ 0.14     | \$ 2.96                    | N/A      |
| <i>Central Appalachia</i>                          |                          |             |                            |          |
| Tons sold (in thousands)                           | 10,445                   | 9,937       | 508                        | 5.1%     |
| Coal sales realization per ton sold <sup>(3)</sup> | \$ 69.12                 | \$ 60.08    | \$ 9.04                    | 15.0%    |
| Operating margin per ton sold <sup>(4)</sup>       | \$ 13.56                 | \$ 6.77     | \$ 6.79                    | 100.3%   |

<sup>(3)</sup> Coal sales prices per ton exclude certain transportation costs that we pass through to our customers. We use these financial measures because we believe the amounts as adjusted better represent the coal sales prices we achieved within our operating segments. Since other companies may calculate coal sales prices per ton differently, our calculation may not be comparable to similarly titled measures used by those companies. For the nine months ended September 30, 2010, transportation costs per ton were \$0.08 for the Powder River Basin, \$3.27 for the Western Bituminous region and \$5.33 for Central Appalachia. For the nine months ended September 30, 2009, transportation costs per ton were \$0.14 for the Powder River Basin, \$2.94 for the Western Bituminous region and \$2.36 for Central Appalachia.

<sup>(4)</sup> Operating margin per ton sold is calculated as coal sales revenues less cost of coal sales and depreciation, depletion and amortization divided by tons sold.

*Powder River Basin* The increase in sales volume in the Powder River Basin in 2010 when compared with 2009 resulted from the acquisition of the Jacobs Ranch mining operations on October 1, 2009, although improving demand for Powder River Basin coal in the third quarter of 2010 also had an impact on sales volumes. Decreases in sales prices during 2010 when compared with 2009 primarily reflect the roll-off of contracts committed when market conditions were more favorable. On a per-ton basis, operating margins in 2010 were flat, as the effect of lower sales prices was offset by a decrease in per-ton costs. The decrease in per-ton costs resulted from efficiencies achieved from combining the acquired Jacobs Ranch mining operations with our existing Black Thunder operations, as well as a decrease in hedged diesel fuel costs.

*Western Bituminous* In the Western Bituminous region, despite a soft steam coal market in the region and the two outages at the Dugout Canyon mine in 2010, sales volumes increased slightly compared to 2009. Sales volumes in 2009 were affected by weaker market conditions that had an impact on our ability to market coal with a high ash content, which resulted from geologic conditions at our West Elk mine, and the decision to reduce production accordingly. We have recently completed construction of a preparation plant at the West Elk mine to address quality issues that could result from



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sandstone intrusions similar to those we encountered previously. Despite the detrimental impact in 2009 on our per-ton realizations of selling coal with a higher ash content, our realizations increased only slightly in 2010, due to the soft steam coal market and an unfavorable mix of customer contracts. Effective cost control in the region resulted in the higher per-ton operating margins in 2010, partially offset by the impact of the two outages at the Dugout Canyon mine in 2010.

*Central Appalachia* The slight increase in sales volumes in 2010, when compared with 2009, was due to the improvement in metallurgical coal demand, partially offset by weaker steam coal demand. We sold 3.8 million tons into metallurgical markets in 2010 compared to 1.2 million tons in 2009. Because metallurgical coal generally commands a higher price than steam coal, the increase had a favorable impact on our average realizations, as did the higher pricing on metallurgical tons sold, compared to 2009. The benefit from higher per-ton realizations in 2010, net of sales sensitive costs, drove the improvement in our operating margins over 2009.

*Net interest expense.* The following table summarizes our net interest expense for the nine months ended September 30, 2010 and compares it with the information for the nine months ended September 30, 2009:

|                  | Nine Months Ended<br>September 30          |             | Decrease in Net<br>Income |         |
|------------------|--------------------------------------------|-------------|---------------------------|---------|
|                  | 2010                                       | 2009        | \$                        | %       |
|                  | (Amounts in thousands, except percentages) |             |                           |         |
| Interest expense | \$ (107,906)                               | \$ (70,466) | \$ (37,440)               | (53.1)% |
| Interest income  | 1,888                                      | 7,284       | (5,396)                   | (74.1)  |
|                  | \$ (106,018)                               | \$ (63,182) | \$ (42,836)               | (67.8)% |

The increase in net interest expense in 2010 compared to 2009 is primarily due to an increase in outstanding senior notes due to the issuance of the 8.75% senior notes in the third quarter of 2009 to finance the acquisition of the Jacobs Ranch mining complex and the issuance of the 7.25% senior notes on August 9, 2010. The proceeds from the issuance 7.25% senior notes were used to redeem a portion of the 6.75% senior notes on September 8, 2010.

In 2009, we recorded interest income of \$6.1 million related to a black lung excise tax refund that we recognized in the fourth quarter of 2008.

*Other non-operating expense.* The following table summarizes our other non-operating expense for the nine months ended September 30, 2010 and compares it with the information for the nine months ended September 30, 2009:

|                                      | Nine Months Ended<br>September 30          |      | Decrease in Net Income |        |
|--------------------------------------|--------------------------------------------|------|------------------------|--------|
|                                      | 2010                                       | 2009 | \$                     | %      |
|                                      | (Amounts in thousands, except percentages) |      |                        |        |
| Loss on early extinguishment of debt | \$ (6,776)                                 | \$   | \$ (6,776)             | (100)% |

Amounts reported as non-operating consist of income or expense resulting from our financing activities, other than interest costs. The loss on early extinguishment of debt relates to the redemption of \$500 million in principal amount of the 6.75% senior notes. The loss includes the payment of \$5.6 million of redemption premium and the write-off of \$3.3 million of unamortized debt financing costs, partially offset by the write-off of \$2.1 million of the original issue premium.

*Income taxes.* Our effective income tax rate is sensitive to changes in estimates of annual profitability and the deduction for percentage depletion. The following table summarizes our income taxes for the nine months ended September 30, 2010 and compares it with information for the nine months ended September 30, 2009:

|  | Nine Months Ended<br>September 30 | Decrease in Net Income |
|--|-----------------------------------|------------------------|
|  |                                   |                        |

|                                           | 2010                                       | 2009       | \$          | %        |
|-------------------------------------------|--------------------------------------------|------------|-------------|----------|
|                                           | (Amounts in thousands, except percentages) |            |             |          |
| Provision for (benefit from) income taxes | \$12,889                                   | \$ (9,590) | \$ (22,479) | (234.4)% |

The income tax provision in 2010 includes a tax benefit of \$4.0 million related to the recognition of tax benefits based on settlements with taxing authorities.

### **Liquidity and Capital Resources**

#### *Liquidity and capital resources*

Our primary sources of cash include sales of our coal production to customers, borrowings under our credit facilities and other financing arrangements, and debt and equity offerings to finance significant transactions.

Excluding any

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

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

In the nine months ended September 30, 2010, we were able to generate record levels of operating cash flows which, when combined with control on capital spending, enabled us to pay down our borrowings under our lines of credit and commercial paper program by approximately \$100.0 million in the third quarter of 2010. At September 30, 2010, our debt-to-capitalization ratio (defined as total debt divided by the sum of total debt and equity) was 43%, a decrease of 3 percentage points from the beginning of the year, and our availability under lines of credit was \$890.1 million.

On August 9, 2010, we issued \$500.0 million in aggregate principal amount of 7.25% senior unsecured notes due in 2020 at par. We used the net proceeds from the offering and cash on hand to fund the redemption on September 8, 2010 of \$500.0 million aggregate principal amount of our outstanding 6.75% senior notes due in 2013 at a redemption price of 101.125%. As a result of the refinancing, we reduced our 2013 principal maturities by more than half.

Interest is payable on the 7.25% senior notes on April 1 and October 1 of each year, commencing April 1, 2011. The notes are guaranteed by most of our subsidiaries, except for Arch Western and its subsidiaries and Arch Receivable Company, LLC. If we fail to meet a coverage ratio test as defined in the indenture, our ability to incur additional debt; pay dividends and make distributions or repurchase stock; make investments; create liens; issue and sell capital stock of subsidiaries; sell assets; enter into restrictions affecting the ability of restricted subsidiaries to make distributions, loans or advances to us; engage in transactions with affiliates; enter into sale and leasebacks; and merge or consolidate or transfer and sell assets would be limited.

At any time on or after October 1, 2015, we may redeem some or all of the notes. The redemption price reflected as a percentage of the principal amount is: 103.625% for notes redeemed between October 1, 2015 and September 30, 2016; 102.417% for notes redeemed between October 1, 2016 and September 30, 2017; 101.208% for notes redeemed between October 1, 2017 and September 30, 2018; and 100% for notes redeemed on or after October 1, 2018. In addition, at any time and from time to time, prior to October 1, 2013, on one or more occasions, we may redeem an aggregate principal amount of senior notes not to exceed 35% of the original aggregate principal amount of the senior notes outstanding with the proceeds of one or more public equity offerings, at a redemption price equal to 107.250%. Upon a change of control, holders of notes have the right to require us to repurchase all of their senior notes at a repurchase price equal to 101% of their principal amount, plus accrued and unpaid interest, if any, to the date of repurchase.

On March 19, 2010, we entered into an amendment to our \$860.0 million secured revolving credit facility. The amendment allows for us to make intercompany loans to our subsidiary, Arch Western Resources LLC ( AWR ), without drawing down the existing loan from AWR to us. We had no borrowings outstanding under the revolving credit facility at September 30, 2010 and \$120.0 million at December 31, 2009. At September 30, 2010, we had availability \$860.0 million under the revolving credit facility. Borrowings under the credit facility bear interest at a floating rate based on LIBOR determined by reference to our leverage ratio, as calculated in accordance with the

credit agreement, as amended. Our revolving credit facility is secured by substantially all of our assets, as well as our ownership interests in substantially all of our subsidiaries, except our ownership interests in AWR. Financial covenants contained in our revolving credit facility, as amended, consist of a maximum leverage ratio, a maximum senior secured leverage ratio and a minimum interest coverage ratio. The leverage ratio requires that we not permit the ratio of total net debt (as defined in the facility) at the end of any calendar quarter to EBITDA (as defined in the facility) for the four quarters then ended to exceed a specified amount. The interest coverage ratio requires that we not permit the ratio of EBITDA (as defined in the facility) at the end of any calendar quarter to interest expense for the four quarters then ended to be less than a specified amount. The senior secured leverage

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ratio requires that we not permit the ratio of total net senior secured debt (as defined in the facility) at the end of any calendar quarter to EBITDA (as defined in the facility) for the four quarters then ended to exceed a specified amount. We were in compliance with all financial covenants at September 30, 2010.

On February 24, 2010, we entered into an amendment of our \$175.0 million accounts receivable securitization program revising certain terms to expand the pool of receivables included in the program. Under the program, eligible trade receivables are sold, without recourse, to a multi-seller, asset-backed commercial paper conduit. The credit facility supporting the borrowings under the program is subject to renewal annually and currently expires on February 23, 2011. Under the terms of the program, eligible trade receivables consist of trade receivables generated by our operating subsidiaries. Actual borrowing capacity is based on the allowable amounts of accounts receivable as defined under the terms of the agreement. We had \$79.4 million of borrowings outstanding under the program at September 30, 2010 and \$84.0 million outstanding at December 31, 2009. We also had letters of credit outstanding under the securitization program of \$65.5 million as of September 30, 2010. At September 30, 2010, we had availability of approximately \$30 million under the accounts receivable securitization program. Although the participants in the program bear the risk of non-payment of purchased receivables, we have agreed to indemnify the participants with respect to various matters. The participants under the program will be entitled to receive payments reflecting a specified discount on amounts funded under the program, including drawings under letters of credit, calculated on the basis of the base rate or commercial paper rate, as applicable. We pay facility fees, program fees and letter of credit fees (based on amounts of outstanding letters of credit) at rates that vary with our leverage ratio. Under the program, we are subject to certain affirmative, negative and financial covenants customary for financings of this type, including restrictions related to, among other things, liens, payments, merger or consolidation and amendments to the agreements underlying the receivables pool. A termination event would permit the administrator to terminate the program and enforce any and all rights, subject to cure provisions, where applicable. Additionally, the program contains cross-default provisions, which would allow the administrator to terminate the program in the event of non-payment of other material indebtedness when due and any other event which results in the acceleration of the maturity of material indebtedness.

On March 25, 2010, we entered into an amendment to our commercial paper program which decreased the maximum aggregate principal amount of the program to \$75 million from \$100 million. The commercial paper program is supported by a line of credit that expires on April 30, 2011. We had commercial paper outstanding of \$55.7 million at September 30, 2010 and \$49.5 million at December 31, 2009. Our commercial paper placement program provides short-term financing at rates that are generally lower than the rates available under our revolving credit facility.

Our subsidiary, Arch Western Finance LLC, has outstanding an aggregate principal amount of \$450.0 million of 6.75% senior notes due on July 1, 2013, subsequent to the redemption discussed previously. The notes are guaranteed by AWR and certain of its subsidiaries and are secured by an intercompany note from Arch Coal, Inc. to AWR. The indenture under which the notes were issued contains certain restrictive covenants that limit AWR's ability to, among other things, incur additional debt, sell or transfer assets and make certain investments. The notes may be redeemed as follows: at 101.125% of par for notes redeemed between July 1, 2010 and June 30, 2011, and at 100% for notes redeemed on or after July 1, 2011.

We have outstanding a principal amount of \$600.0 million of 8.75% senior notes due on August 1, 2016. At any time on or after August 1, 2013, we may redeem some or all of the notes. The redemption price, reflected as a percentage of the principal amount, is: 104.375% for notes redeemed between August 1, 2013 and July 31, 2014; 102.188% for notes redeemed between August 1, 2014 and July 31, 2015; and 100% for notes redeemed on or after August 1, 2015. The notes are guaranteed by most of our subsidiaries, except for AWR and its subsidiaries and Arch Receivable Company, LLC, among others.

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



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

|                             | <b>Nine Months Ended September 30</b> |             |
|-----------------------------|---------------------------------------|-------------|
|                             | <b>2010</b>                           | <b>2009</b> |
|                             | <b>(in thousands)</b>                 |             |
| Cash provided by (used in): |                                       |             |
| Operating activities        | \$ 456,680                            | \$ 246,443  |
| Investing activities        | (261,786)                             | (309,245)   |
| Financing activities        | (192,279)                             | 832,446     |

Cash provided by operating activities increased in 2010 compared to 2009, primarily as a result of our increased profits during the year, driven primarily by higher sales volumes.

Cash used in investing activities in 2010 was \$47.5 million less than in 2009, primarily due to a \$58.5 million reduction in capital expenditures. During 2010, we made payments of \$93.1 million on our Montana leases and spent \$25.4 million on the new preparation plant at the West Elk mine that we mentioned previously. In 2009, in addition to the last payment of \$122.0 million on the Little Thunder federal coal lease, we spent approximately \$19.0 million on additional longwall equipment at the West Elk mining complex in Colorado and approximately \$38.0 million on a new shovel and haul trucks at the Black Thunder mine in Wyoming.

Cash used in financing activities was \$192.3 million during 2010, compared to cash provided by financing activities of \$832.4 million during 2009. As mentioned previously, we used the net proceeds from the offering of the 7.25% notes and cash on hand to fund the redemption on September 8, 2010 of \$500.0 million aggregate principal amount of our outstanding 6.75% senior notes due in 2013 at a redemption price of 101.125%. We also repaid approximately \$118 million under our various financing arrangements during 2010, compared to maintaining level debt levels under these arrangements during 2009. We paid financing costs of \$12.6 million in 2010.

In 2009, we sold 19.55 million shares of our common stock at a public offering price of \$17.50 per share and issued \$600 million in aggregate principal amount of 8.750% senior unsecured notes due 2016. Total net proceeds from these transactions were \$896.8 million. We used the net proceeds from these transactions primarily to finance the purchase of the Jacobs Ranch mining complex, which closed on October 1, 2009. We paid financing costs of \$29.6 million in 2009.

**Ratio of Earnings to Fixed Charges**

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

|                                                                      | <b>Nine Months Ended September 30</b> |             |
|----------------------------------------------------------------------|---------------------------------------|-------------|
|                                                                      | <b>2010</b>                           | <b>2009</b> |
| Ratio of earnings to combined fixed charges and preference dividends | 2.10                                  | 1.41        |

**Critical Accounting Policies**

For a description of our critical accounting policies, see Critical Accounting Policies under Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2009. There have been no significant changes to our critical accounting policies during the three and nine months ended September 30, 2010.

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

We manage our commodity price risk for our non-trading, long-term coal contract portfolio through the use of long-term coal supply agreements, and to a limited extent, through the use of derivative instruments. At September 30, 2010, based on our expected production levels and current sales commitments, we have committed substantially all of our 2010 production, with 5 million tons not yet priced. Arch has uncommitted volumes of 30 million to 40 million tons in 2011, and uncommitted volumes of 70 million to 80 million tons in 2012, with roughly 15 million tons committed but not yet priced in both 2011 and 2012.

We are exposed to commodity price risk in our coal trading activities, which represents the potential future loss that could be caused by an adverse change in the market value of coal. Our coal trading portfolio included forward, swap and put and call option contracts at September 30, 2010. With respect to our coal trading portfolio at September 30, 2010, the potential for loss of future earnings resulting from changing coal prices was insignificant. The estimated future realization of the value of the trading portfolio is \$1.4 million for the remainder of 2010, \$4.6 million in 2011 and \$(0.8) million in 2012.



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

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

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

During the nine months ended September 30, 2010, VaR ranged from under \$0.1 million to \$0.8 million. The linear mean of each daily VaR was \$0.3 million. The final VaR at September 30, 2010 was \$0.7 million.

We are also exposed to the risk of fluctuations in cash flows related to our purchase of diesel fuel. We use approximately 60 million to 70 million gallons of diesel fuel annually in our operations. We enter into forward physical purchase contracts, as well as heating oil swaps and options, to reduce volatility in the price of diesel fuel for our operations. At September 30, 2010, the Company had protected the price of approximately 67% of its expected purchases for the remainder of fiscal year 2010 and 55% for fiscal year 2011, mostly through the use of the derivative instruments noted above. Since the changes in the price of heating oil are highly correlated to changes in the price of the hedged diesel fuel purchases, the heating oil swaps and purchased call options qualify for cash flow hedge accounting. Accordingly, changes in the fair value of the derivatives are recorded through other comprehensive income, with any ineffectiveness recognized immediately in income. At September 30, 2010, a \$0.25 per gallon decrease in the price of heating oil would result in an approximate \$4.3 million increase in our expense related to the heating oil derivatives, which, if realized, would be offset by a decrease in the cost of our physical diesel purchases.

We are exposed to market risk associated with interest rates due to our existing level of indebtedness. At September 30, 2010, of our \$1.7 billion principal amount of debt outstanding, approximately \$135 million of outstanding borrowings have interest rates that fluctuate based on changes in the respective market rates. A one percentage point increase in the interest rates related to these borrowings would result in an annualized increase in interest expense of \$1.4 million, based on borrowing levels at September 30, 2010.

**Item 4. Controls and Procedures.**

We performed an evaluation under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2010. Based on that evaluation, our management, including our chief executive officer and chief financial officer, concluded that the disclosure controls and procedures were effective as of such date. There were no changes in internal control over financial reporting that occurred during our fiscal quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II  
OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are involved in various claims and legal actions in the ordinary course of business. In the opinion of management, the outcome of such ordinary course of business proceedings and litigation currently pending will not have a material adverse effect on our results of operations or financial results.

**Permit Litigation Matters**

As described in our Annual Report on Form 10-K for the year ended December 31, 2009, 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 ( the 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 claiming that permits it had issued to four subsidiaries of a company unrelated to us or our operating subsidiaries 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.

On February 13, 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 on May 29, 2009 and the decision was given legal effect on June 24, 2009. An appeal to the U.S. Supreme Court was then filed on August 26, 2009. On August 3, 2010 OVEC withdrew its appeal.

Mingo Logan filed a motion for summary judgment with the district court on July 17, 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 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 until the earlier of either six months or the completion of the U.S. Environmental Protection Agency's (the EPA) proposed action to deny Mingo Logan the right to use its Corps' permit (as discussed below).

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On September 24, 2010, EPA Region 3 issued a Recommended Determination to the EPA Administrator recommending that EPA prohibit the placement of fill material in two of the three watersheds for which filling is approved under the current Section 404 permit. On October 15, 2010, the United States moved to extend the existing stay for an additional 120 days (until February 22, 2011) while the EPA Administrator reviews the Recommended Determination issued by EPA Region 3. By order dated November 2, 2010, the District Court extended the stay until February 22, 2011.

**Potential EPA Prohibitions Related to Water Discharges from the Spruce Permit**

As described in our Annual Report on Form 10-K for the year ended December 31, 2009, by letter of September 3, 2009, the EPA asked the Corps 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 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, 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. The EPA is required to consult with us, along with the Corps and the State of West Virginia, prior to issuing a final decision. 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 has moved to dismiss that action, and we have responded to that motion. The motion is now pending before the Court.

You should see Part I, Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2009 for more information about some of the additional proceedings and litigation in which we are involved.

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

In September 2006, our board of directors authorized a share repurchase program for the purchase of up to 14,000,000 shares of our common stock. There is no expiration date on the current authorization, and we have not made any decisions to suspend or cancel purchases under the program. As of September 30, 2010, there were 10,925,800 shares of our common stock available for purchase under this program. We did not purchase any shares of our common stock under this program during the quarter ended September 30, 2010. Based on the closing price of our common stock as reported on the New York Stock Exchange on November 5, 2010, the approximate dollar value of our common stock that may yet be purchased under this program was \$309.2 million.

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

None

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

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



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Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, each operator of a coal or other mine is required to include certain mine safety results in its periodic reports filed with the Securities and Exchange Commission. The operation of our mines is subject to regulation by the federal Mine Safety and Health Administration ( MSHA ) under the Federal Mine Safety and Health Act of 1977 (the Mine Act ). Below we present the following items regarding certain mine safety and health matters, broken down by mining complex owned and operated by Arch Coal or our subsidiaries, for the three-month period ended September 30, 2010:

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

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

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

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

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

|                            | <b>Section<br/>104</b> | <b>Section<br/>104(b)</b> | <b>Section<br/>104(d)</b> | <b>Section<br/>107(a)</b> | <b>Total Dollar<br/>Value<br/>of Proposed<br/>MSHA<br/>Assessments<br/>(in<br/>thousands)(2)</b> |
|----------------------------|------------------------|---------------------------|---------------------------|---------------------------|--------------------------------------------------------------------------------------------------|
| <b>Mining complex(1)</b>   | <b>Citations</b>       | <b>Orders</b>             | <b>Citations/Orders</b>   | <b>Orders</b>             |                                                                                                  |
| <b>Power River Basin:</b>  |                        |                           |                           |                           |                                                                                                  |
| Black Thunder              | 1                      |                           |                           |                           | \$ 2                                                                                             |
| Coal Creek                 |                        |                           |                           |                           | \$                                                                                               |
| <b>Western Bituminous:</b> |                        |                           |                           |                           |                                                                                                  |
| Arch of Wyoming            |                        |                           |                           |                           | \$ 1                                                                                             |
| Dugout Canyon              | 8                      |                           |                           |                           | \$ 2                                                                                             |
| Skyline                    | 14                     |                           |                           |                           | \$ 14                                                                                            |
| Sufco                      | 5                      |                           | 4                         | 1                         | \$ 1                                                                                             |
| West Elk                   | 22                     |                           |                           |                           | \$ 78                                                                                            |
| <b>Central Appalachia:</b> |                        |                           |                           |                           |                                                                                                  |
| Coal-Mac                   | 10                     |                           |                           |                           | \$ 11                                                                                            |
| Cumberland River           | 29                     |                           |                           |                           | \$ 22                                                                                            |
| Lone Mountain              | 38                     |                           | 2                         |                           | \$ 37                                                                                            |
| Mountain Laurel            | 40                     |                           |                           |                           | \$ 48                                                                                            |
| <b>Arch Coal Terminal</b>  |                        |                           |                           |                           | \$ 1                                                                                             |

- (1) MSHA assigns an identification number to each coal mine and may or may not assign separate identification numbers to related facilities such as preparation plants. We are providing the information in this table by mining complex rather than MSHA identification number because we believe this format will be more useful to investors

than providing information based on MSHA identification numbers. For descriptions of each of these mining operations please refer to the descriptions under Item 1. Business, in Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

- (2) Amounts included under the heading **Total Dollar Value of Proposed MSHA Assessments** are the total dollar amounts for proposed assessments received from MSHA on or before October 25, 2010, for citations and orders occurring during the three-month period ended September 30, 2010.

For the three-month period ended September 30, 2010, none of our mining complexes received written notice from MSHA of (i) a flagrant violation under section 110(b)(2) of the Mine Act; (ii) a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of the Mine Act; or (iii) the potential to have such a pattern. For the three-month period ended September 30, 2010, none of our mining complexes experienced a mining-related fatality.

As of September 30, 2010, we had a total of ninety-three matters pending before the Federal Mine Safety and Health Review Commission. This includes legal actions that were initiated prior to the three-month period ended September 30,

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2010 and which do not necessarily relate to the citations, orders or proposed assessments issued by MSHA during such three-month period.

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

**Item 6. Exhibits.**

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

| Exhibit | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|---------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4.1     | Indenture, dated August 9, 2010, by and among Arch Coal, Inc. and U.S. Bank National Association, as trustee (incorporated herein by reference to Exhibit 4.1 to Arch Coal, Inc.'s Current Report on Form 8-K filed on August 9, 2010).                                                                                                                                                                                                                                       |
| 4.2     | First Supplemental Indenture, dated August 9, 2010, by and among Arch Coal, Inc., the subsidiary guarantors named therein and U.S. Bank National Association, as trustee (incorporated herein by reference to Exhibit 4.2 to Arch Coal, Inc.'s Current Report on Form 8-K filed on August 9, 2010).                                                                                                                                                                           |
| 4.3     | Form of 7 1/4% Senior Notes due 2020 (included in Exhibit 4.2).                                                                                                                                                                                                                                                                                                                                                                                                               |
| 10.1    | Underwriting Agreement, dated August 2, 2010, by and among Arch Coal, Inc., the subsidiary guarantors named therein and Banc of America Securities LLC, Citigroup Global Markets Inc., Morgan Stanley & Co. Incorporated and J.P. Morgan Securities Inc., as representatives of the several underwriters named therein (incorporated herein by reference to Exhibit 1.1 to Arch Coal, Inc.'s Current Report on Form 8-K filed on August 3, 2010).                             |
| 10.2*   | Arch Coal, Inc. 1997 Stock Incentive Plan (as amended and restated on October 21, 2010) (incorporated herein by reference to Exhibit 10.1 to Arch Coal, Inc.'s Current Report on Form 8-K filed on October 27, 2010).                                                                                                                                                                                                                                                         |
| 12.1    | Computation of ratio of earnings to combined fixed charges and preference dividends.                                                                                                                                                                                                                                                                                                                                                                                          |
| 31.1    | Rule 13a-14(a)/15d-14(a) Certification of Steven F. Leer.                                                                                                                                                                                                                                                                                                                                                                                                                     |
| 31.2    | Rule 13a-14(a)/15d-14(a) Certification of John T. Drexler.                                                                                                                                                                                                                                                                                                                                                                                                                    |
| 32.1    | Section 1350 Certification of Steven F. Leer.                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| 32.2    | Section 1350 Certification of John T. Drexler.                                                                                                                                                                                                                                                                                                                                                                                                                                |
| 101     | Interactive Data File (Form 10-Q for the quarter ended September 30, 2010 furnished in XBRL). The financial information contained in the XBRL-related documents is unaudited and unreviewed and, in accordance with Rule 406T of Regulation S-T, is not deemed filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under these sections. |

\* Denotes management contract or compensatory plan arrangement.

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**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

November 9, 2010

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