

ARCH COAL INC  
Form 10-Q  
May 08, 2013  
Table of Contents

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

---

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended March 31, 2013**

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

**For the transition period from                      to                      .**

**Commission file number: 1-13105**

## Arch Coal, Inc.

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction  
of incorporation or organization)

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

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

**63141**  
(Zip code)

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

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

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  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 May 1, 2013 there were 212,246,799 shares of the registrant's common stock outstanding.



Table of Contents

TABLE OF CONTENTS

	<b>Page</b>
<u>Part I FINANCIAL INFORMATION</u>	3
<u>Item 1. Financial Statements</u>	3
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	28
<u>Item 4. Controls and Procedures</u>	30
<u>Part II OTHER INFORMATION</u>	30
<u>Item 1. Legal Proceedings</u>	30
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	33
<u>Item 4. Mine Safety Disclosures</u>	33
<u>Item 6. Exhibits</u>	34

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

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(Unaudited)</b>	
<b>Revenues</b>	\$ 825,502	\$ 1,039,651
<b>Costs, expenses and other</b>		
Cost of sales (exclusive of items shown separately below)	710,573	850,871
Depreciation, depletion and amortization	118,868	139,966
Amortization of acquired sales contracts, net	(2,810)	(14,017)
Change in fair value of coal derivatives and coal trading activities, net	1,308	(3,613)
Selling, general and administrative expenses	33,209	30,861
Other operating income, net	(3,217)	(18,498)
	857,931	985,570
Income (loss) from operations	(32,429)	54,081
Interest expense, net:		
Interest expense	(95,087)	(74,772)
Interest and investment income	2,836	1,021
	(92,251)	(73,751)
Loss before income taxes	(124,680)	(19,670)
Benefit from income taxes	(54,631)	(21,079)
Net income (loss)	(70,049)	1,409
Less: Net income attributable to noncontrolling interest		(203)
Net income (loss) attributable to Arch Coal, Inc.	\$ (70,049)	\$ 1,206
<b>Earnings per common share</b>		
Basic earnings (loss) per common share	\$ (0.33)	\$ 0.01
Diluted earnings (loss) per common share	\$ (0.33)	\$ 0.01
Weighted average shares outstanding		
Basic	212,062	211,687
Diluted	212,062	211,908
Dividends declared per common share	\$ 0.03	\$ 0.11

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



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

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(Unaudited)</b>	
Net income (loss)	\$ (70,049)	\$ 1,409
Derivative instruments		
Total comprehensive income (loss) before tax	(1,179)	10,287
Tax impact	425	(3,702)
	(754)	6,585
Pension, postretirement and other post-employment benefits		
Total comprehensive income before tax	1,954	724
Tax impact	(703)	(261)
	1,251	463
Available-for-sale securities		
Total comprehensive income before tax	1,553	394
Tax impact	(559)	(142)
	994	252
Total other comprehensive income	1,491	7,300
Total comprehensive income (loss)	\$ (68,558)	\$ 8,709

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

Table of Contents

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

	March 31, 2013	December 31, 2012
	(Unaudited)	
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 730,119	\$ 784,622
Restricted cash	2,290	3,453
Short term investments	248,414	234,305
Trade accounts receivable	263,294	247,539
Other receivables	81,750	84,541
Inventories	368,240	365,424
Prepaid royalties	13,105	11,416
Deferred income taxes	67,337	67,360
Coal derivative assets	20,856	22,975
Other	88,977	92,469
Total current assets	1,884,382	1,914,104
<b>Property, plant and equipment, net</b>	<b>7,272,541</b>	<b>7,337,098</b>
Other assets:		
Prepaid royalties	91,691	87,773
Goodwill	265,423	265,423
Equity investments	246,807	242,215
Other	159,300	160,164
Total other assets	763,221	755,575
Total assets	\$ 9,920,144	\$ 10,006,777
<b>Liabilities and Stockholders Equity</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 229,269	\$ 224,418
Coal derivative liabilities	643	1,737
Accrued expenses and other current liabilities	352,040	318,018
Current maturities of debt	28,306	32,896
Total current liabilities	610,258	577,069
Long-term debt	5,082,205	5,085,879
Asset retirement obligations	410,975	409,705
Accrued pension benefits	69,342	67,630
Accrued postretirement benefits other than pension	46,413	45,086
Accrued workers compensation	81,039	81,629
Deferred income taxes	610,195	664,182
Other noncurrent liabilities	227,363	221,030
Total liabilities	7,137,790	7,152,210
<b>Stockholders equity</b>		
Common stock, \$0.01 par value, authorized 260,000 shares, issued 213,759 shares at both March 31, 2013 and December 31, 2012	2,141	2,141
Paid-in capital	3,029,536	3,026,823
Treasury stock, at cost	(53,848)	(53,848)
Accumulated deficit	(180,459)	(104,042)
Accumulated other comprehensive loss	(15,016)	(16,507)
Total stockholders equity	2,782,354	2,854,567
Total liabilities and stockholders equity	\$ 9,920,144	\$ 10,006,777



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

Table of Contents

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

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(Unaudited)</b>	
<b>Operating activities</b>		
Net income (loss)	\$ (70,049)	\$ 1,409
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Depreciation, depletion and amortization	118,868	139,966
Amortization of acquired sales contracts, net	(2,810)	(14,017)
Amortization relating to financing activities	6,167	4,288
Prepaid royalties expensed	3,537	8,586
Employee stock-based compensation expense	2,713	4,079
Changes in:		
Receivables	(12,340)	88,082
Inventories	(2,816)	(111,196)
Coal derivative assets and liabilities	(192)	(5,347)
Accounts payable, accrued expenses and other current liabilities	38,249	(66,222)
Income taxes, net	458	23,002
Deferred income taxes	(54,801)	(21,742)
Other	16,307	4,102
Cash provided by operating activities	43,291	54,990
<b>Investing activities</b>		
Capital expenditures	(54,522)	(93,271)
Minimum royalty payments	(9,142)	(8,262)
Proceeds from dispositions of property, plant and equipment	714	22,105
Purchases of short term investments	(26,787)	
Proceeds from sales of short term investments	11,534	
Investments in and advances to affiliates	(4,298)	(5,777)
Change in restricted cash	1,163	1,455
Cash used in investing activities	(81,338)	(83,750)
<b>Financing activities</b>		
Net increase in borrowings under lines of credit		34,000
Payments on term note	(4,125)	
Net payments on other debt	(5,964)	(7,323)
Debt financing costs		(100)
Dividends paid	(6,367)	(23,327)
Proceeds from exercise of options under incentive plans		5,131
Cash provided by (used in) financing activities	(16,456)	8,381
Decrease in cash and cash equivalents	(54,503)	(20,379)
Cash and cash equivalents, beginning of period	784,622	138,149
Cash and cash equivalents, end of period	\$ 730,119	\$ 117,770

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



Table of Contents

**Arch Coal, Inc. and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements include the accounts of Arch Coal, Inc. and its subsidiaries and controlled entities (the Company). The Company's primary business is the production of thermal and metallurgical coal from surface and underground mines located throughout the United States, for sale to utility, industrial and steel producers both in the United States and around the world. The Company currently operates 16 mining complexes in West Virginia, Kentucky, Maryland, Virginia, Illinois, Wyoming, Colorado and Utah. In addition, the Company has a metallurgical coal mine in development in West Virginia. All subsidiaries are wholly-owned. Intercompany transactions and accounts have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial reporting and U.S. Securities and Exchange Commission regulations. In the opinion of management, all adjustments, consisting of normal, recurring accruals considered necessary for a fair presentation, have been included. Results of operations for the three month period ended March 31, 2013 are not necessarily indicative of results to be expected for the year ending December 31, 2013. 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, 2012 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission.

Arch Western Resources, LLC became a wholly-owned subsidiary when the remaining 0.5% interest was purchased on July 2, 2012. Net income attributable to noncontrolling interest is shown on the condensed consolidated statement of operations prior to this date.

**2. Accounting Policies**

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

**3. Accumulated Other Comprehensive Loss**

Other comprehensive loss includes transactions recorded in stockholders' equity during the year, excluding net income and transactions with stockholders. In February 2013, the FASB issued ASU 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The standard requires that companies present, either parenthetically on the face of the financial statements or in a single note, the effect of significant amounts reclassified from each component of accumulated other comprehensive income and the income statement line items

Edgar Filing: ARCH COAL INC - Form 10-Q

affected by the reclassification. The Company adopted the provisions of the new guidance during the first quarter of 2013.

The following items are included in accumulated other comprehensive loss:

	Derivative Instruments	Pension, Postretirement and Other Post- Employment Benefits	Available-for- Sale Securities	Accumulated Other Comprehensive Loss
(In thousands)				
Balance at December 31, 2012	\$ 2,244	\$ (18,286)	\$ (465)	\$ (16,507)
Unrealized gains (losses)	(204)		956	752
Amounts reclassified from accumulated other comprehensive income	(550)	1,251	38	739
Balance at March 31, 2013	\$ 1,490	\$ (17,035)	\$ 529	\$ (15,016)

The following items were reclassified out of accumulated other comprehensive loss during the three months ended March 31, 2013:

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

### Table of Contents

Details about accumulated other comprehensive income components	Amount Reclassified From Accumulated Other Comprehensive Loss (In thousands)	Affected Line Item in the Condensed Consolidated Statement of Operations
Derivatives instruments	\$	859 Revenues
		(309) Benefit from income taxes
	\$	550 Net of tax
<b>Pension, postretirement and other post-employment benefits</b>		
Amortization of prior service credits	\$	2,908 (1)
Amortization of actuarial gains (losses) net		(4,862) (1)
		(1,954) Total before tax
		703 Benefit from income taxes
	\$	(1,251) Net of tax
Available-for-sale securities	\$	(59) Interest and investment income
		21 Benefit from income taxes
	\$	(38) Net of tax

(1) Production-related benefit and workers' compensation costs are included in the costs of coal inventory. See Note 12, Workers' Compensation Expense and Note 13 Employee Benefit Plans for more information about pension, postretirement and postemployment benefit costs.

#### 4. Inventories

Inventories consist of the following:

	March 31 2013	December 31 2012
	(In thousands)	
Coal	\$ 182,998	\$ 180,917
Repair parts and supplies	170,040	172,139
Work-in-process	15,202	12,368
	\$ 368,240	\$ 365,424

The repair parts and supplies are stated net of an allowance for slow-moving and obsolete inventories of \$14.0 million at March 31, 2013, and \$13.6 million at December 31, 2012.

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

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

losses are recorded through other comprehensive income.

Edgar Filing: ARCH COAL INC - Form 10-Q

Table of Contents

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

	March 31, 2013						Balance Sheet Classification	
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Short-Term Investments	Other Assets		
							(In thousands)	
Available-for-sale:								
U.S. government and agency securities	\$ 135,457	\$ 1	\$ (705)	\$ 134,753	\$ 134,753	\$		
Corporate notes and bonds	114,905		(1,244)	113,661	113,661			
Equity securities	5,271	5,547	(2,774)	8,044				8,044
<b>Total Investments</b>	<b>\$ 255,633</b>	<b>\$ 5,548</b>	<b>\$ (4,723)</b>	<b>\$ 256,458</b>	<b>\$ 248,414</b>	<b>\$</b>	<b>\$</b>	<b>8,044</b>

	December 31, 2012						Balance Sheet Classification	
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Short-Term Investments	Other Assets		
							(In thousands)	
Available-for-sale:								
U.S. government and agency securities	\$ 146,993	\$ 2	\$ (412)	\$ 146,583	\$ 146,583	\$		
Corporate notes and bonds	88,118		(396)	87,722	87,722			
Equity securities	5,271	2,704	(2,628)	5,347				5,347
<b>Total Investments</b>	<b>\$ 240,382</b>	<b>\$ 2,706</b>	<b>\$ (3,436)</b>	<b>\$ 239,652</b>	<b>\$ 234,305</b>	<b>\$</b>	<b>\$</b>	<b>5,347</b>

The aggregate fair value of investments with unrealized losses that have been owned for less than a year was \$245.4 million and \$223.3 million at March 31, 2013 and December 31, 2012, respectively. The aggregate fair value of investments with unrealized losses that have been owned for over a year was \$0.3 million and \$0.4 million at March 31, 2013 and December 31, 2012, respectively.

The debt securities outstanding at March 31, 2013 have maturity dates ranging from the second quarter of 2013 through the third quarter of 2014. The Company classifies its investments as current based on the nature of the investments and their availability for use in current operations.

**6. Equity Method Investments and Membership Interests in Joint Ventures**

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

In thousands	Knight Hawk	DKRW	DTA	Tenaska	Millennium	Tongue River	Total
--------------	-------------	------	-----	---------	------------	--------------	-------



Edgar Filing: ARCH COAL INC - Form 10-Q

Balance at														
December 31, 2012	\$	149,063	\$	15,515	\$	15,462	\$	15,264	\$	32,214	\$	14,697	\$	242,215
Advances to affiliates, net				593				1,790		1,001				3,384
Equity in comprehensive income (loss)		4,515		(733)		(1,609)		(684)		(281)				1,208
Balance at														
March 31, 2013	\$	153,578	\$	14,782	\$	14,446	\$	15,264	\$	33,320	\$	15,417	\$	246,807
<b>Notes receivable from investees:</b>														
Balance at														
December 31, 2012	\$		\$	38,680	\$		\$	5,148	\$		\$		\$	43,828
Balance at														
March 31, 2013	\$		\$	41,019	\$		\$	5,197	\$		\$		\$	46,216

The Company may be required to make future contingent payments of up to \$72.8 million related to development financing for certain of its equity investees. The Company's obligation to make these payments, as well as the timing of any payments required, is contingent upon a number of factors, including project development progress, receipt of permits and construction financing.

## 7. Derivatives

### *Diesel fuel price risk management*

The Company is exposed to price risk with respect to diesel fuel purchased for use in its operations. The Company anticipates purchasing approximately 57 to 67 million gallons of diesel fuel for use in its operations during 2013. To protect the Company's cash flows from increases in the price of diesel fuel for its operations, the Company uses forward physical diesel purchase contracts and purchased heating oil call options. At March 31, 2013, the Company had protected the price of approximately 97% of its expected purchases for the remainder of 2013 and 42% of its 2014 purchases. At March 31, 2013, the Company had purchased heating oil call options for approximately 71 million gallons for the purpose of managing the price risk associated with future diesel purchases.

The Company also purchased heating oil call options to manage the price risk associated with fuel surcharges on its barge and rail shipments, which cover increases in diesel fuel prices. At March 31, 2013, the Company held purchased call options for approximately 6 million gallons for the purpose of managing the fluctuations in cash flows associated with fuel surcharges on future shipments.

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

### *Coal risk management positions*

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

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

At March 31, 2013, the Company held derivatives for risk management purposes that are expected to settle in the following years:

(Tons in thousands)	2013	2014	2015	Total
Coal sales	5,399	4,260	780	10,439
Coal purchases	1,131	1,260		2,391

### *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 \$4.1 million of losses in 2013 and \$3.6 million of gains in 2014.

Table of Contents*Tabular derivatives disclosures*

The Company has master netting agreements with all of its counterparties which allow for the settlement of contracts in an asset position with contracts in a liability position in the event of default or termination. Such netting arrangements reduce the Company's credit exposure related to these counterparties. For classification purposes, the Company records the net fair value of all the positions with a given counterparty as a net asset or liability in the condensed consolidated balance sheets. The amounts shown in the table below represent the fair value position of individual contracts, and not the net position presented in the accompanying condensed consolidated balance sheets. The fair value and location of derivatives reflected in the accompanying condensed consolidated balance sheets are as follows:

Fair Value of Derivatives (In thousands)	March 31, 2013		December 31, 2012	
	Asset Derivative	Liability Derivative	Asset Derivative	Liability Derivative
<b>Derivatives Designated as Hedging Instruments</b>				
Coal	\$ 2,379	\$ (252)	\$ 3,277	\$ (10)
<b>Derivatives Not Designated as Hedging Instruments</b>				
Heating oil diesel purchases	6,227		7,379	
Heating oil fuel surcharges	207		1,961	
Coal held for trading purposes	41,675	(42,234)	17,403	(16,933)
Coal risk management	22,354	(3,709)	24,843	(7,342)
Total	70,463	(45,943)	51,586	(24,275)
Total derivatives	72,842	(46,195)	54,863	(24,285)
Effect of counterparty netting	(45,552)	45,552	(22,548)	22,548
<b>Net derivatives as classified in the balance sheets</b>	\$ 27,290	\$ (643)	\$ 26,647	\$ (1,737)
			\$ 30,578	

Net derivatives as reflected on the balance sheets	March 31, 2013		December 31, 2012	
	Asset	Liability	Asset	Liability
<b>Heating oil</b>				
Other current assets	\$ 6,434		\$ 9,340	
<b>Coal</b>				
Coal derivative assets	20,856		22,975	
Coal derivative liabilities		(643)		(1,737)
	\$ 26,647	\$ (643)	\$ 22,975	\$ (1,737)
			\$ 30,578	

The Company had a current asset for the right to reclaim cash collateral of \$24.6 million and \$16.2 million at March 31, 2013 and December 31, 2012, respectively. These amounts are not included with the derivatives presented in the table above and are included in "other current assets" in the accompanying condensed consolidated balance sheets.

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

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

For the three months ended March 31,

Edgar Filing: ARCH COAL INC - Form 10-Q

		Gain (Loss) Recognized in Other Comprehensive Income (Effective Portion)		Gains (Losses) Reclassified from Other Comprehensive Income into Income (Effective Portion)	
		2013	2012	2013	2012
Coal sales	(1) \$	(176)	\$ 2,493	\$ 1,221	\$ 201
Coal purchases	(2)	(182)	(202)	(362)	
Totals	\$	(358)	\$ 2,291	\$ 859	\$ 201

No ineffectiveness or amounts excluded from effectiveness testing relating to the Company's cash flow hedging relationships were recognized in the results of operations in the three month periods ended March 31, 2013 and 2012.

Table of Contents**Derivatives Not Designated as Hedging Instruments (in thousands)**

For the three months ended March 31,

		Gain (Loss) Recognized	
		2013	2012
Coal unrealized	(3) \$	1,470	\$ 7,552
Coal realized	(4) \$	9,217	\$ 3,158
Heating oil diesel purchases	(4) \$	(4,261)	\$ 423
Heating oil fuel surcharges	(4) \$	(565)	\$ 367

**Location in statement of operations:**

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

The Company recognized net unrealized and realized losses of \$2.8 million and \$3.9 million during the three months ended March 31, 2013 and 2012, respectively, related to its trading portfolio, which are included in the caption Change in fair value of coal derivatives and coal trading activities, net in the accompanying condensed consolidated statements of operations, and are not included in the previous tables reflecting the effects of derivatives on measures of financial performance.

Based on fair values at March 31, 2013, gains on derivative contracts designated as hedge instruments in cash flow hedges of approximately \$1.0 million are expected to be reclassified from other comprehensive income into earnings during the next twelve months.

**8. Debt**

	March 31, 2013		December 31, 2012	
	(In thousands)			
Term loan (\$1.64 billion face value) due 2018	\$	1,623,955	\$	1,627,384
8.75% senior notes (\$600.0 million face value) due 2016		591,535		590,999
7.00% senior notes due 2019 at par		1,000,000		1,000,000
9.875% senior notes (\$375.0 million face value) due 2019		360,621		360,042
7.25% senior notes due 2020 at par		500,000		500,000
7.25% senior notes due 2021 at par		1,000,000		1,000,000
Other		34,400		40,350
		5,110,511		5,118,775

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

Less current maturities of debt		28,306		32,896
Long-term debt	\$	5,082,205	\$	5,085,879

### 9. Fair Value Measurements

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

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

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

### Table of Contents

Company's level 2 assets and liabilities include U.S. government agency securities and commodity contracts (coal and heating oil) with fair values derived from quoted prices in over-the-counter markets or from prices received from direct broker quotes.

- Level 3 is defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. These include the Company's commodity option contracts (coal and heating oil) valued using modeling techniques, such as Black-Scholes, that require the use of inputs, particularly volatility, that are rarely observable. Changes in the unobservable inputs would not have a significant impact on the reported Level 3 fair values at March 31, 2013.

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

	Total	Fair Value at March 31, 2013			Level 3
		Level 1	Level 2	(In thousands)	
<b>Assets:</b>					
Investments in marketable securities	\$ 256,458	\$ 98,410	\$ 158,048		
Derivatives	27,290	21,250			6,040
<b>Total assets</b>	<b>\$ 283,748</b>	<b>\$ 119,660</b>	<b>\$ 158,048</b>	<b>\$ 6,040</b>	
<b>Liabilities:</b>					
Derivatives	\$ 643		\$ 245		\$ 398

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

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

	<b>Three Months Ended March 31, 2013</b>	
Balance, beginning of period	\$	8,174
Realized and unrealized losses recognized in earnings, net		(4,472)
Realized and unrealized losses recognized in other comprehensive income, net		
Purchases		3,217
Issuances		(25)
Settlements		(1,252)
<b>Ending balance</b>	<b>\$</b>	<b>5,642</b>

Net unrealized losses during the three month period ended March 31, 2013 related to level 3 financial instruments held on March 31, 2013 were \$4.0 million.

*Fair Value of Long-Term Debt*

At March 31, 2013 and December 31, 2012, the fair value of the Company's debt, including amounts classified as current, was \$5.0 billion. Fair values are based upon observed prices in an active market, when available, or from valuation models using market information, which fall into Level 2 in the fair value hierarchy.

**10. Accrued Expenses and Other Current Liabilities**

Accrued expenses and other current liabilities consist of the following:



Table of Contents

	March 31, 2013	December 31, 2012
	(In thousands)	
Payroll and employee benefits	\$ 63,375	\$ 72,405
Taxes other than income taxes	121,159	121,029
Interest	83,855	42,413
Acquired sales contracts	14,456	14,038
Workers compensation	12,732	10,371
Asset retirement obligations	38,919	38,920
Other	17,544	18,842
	\$ 352,040	\$ 318,018

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

During the three months ended March 31, 2013 the Company granted options to purchase approximately 2.0 million shares of common stock with a weighted average exercise price of \$5.23 per share and a weighted average grant-date fair value of \$2.38 per share. The options' fair value was determined using the Black-Scholes option pricing model, using a weighted average risk-free rate of 0.648%, a weighted average dividend yield of 2.29% and a weighted average volatility of 66.76%. The options' expected life is 4.5 years and the options vest ratably over three years and provide for the continuation of vesting after retirement for recipients that meet certain criteria. The expense for these options will be recognized through the date that the employee first becomes eligible to retire and is no longer required to provide service to earn all or part of the award.

During the three months ended March 31, 2013, the Company also granted restricted stock units totaling 974,500 shares whose grant date fair value at the time of grant was \$5.23. The shares vest at the end of three years.

The Company has a long-term incentive program that allows for the award of performance units. The total number of units earned by a participant is based on financial and operational performance measures, and may be paid out in cash or in shares of the Company's common stock. The Company recognizes compensation expense over the three-year term of the grant. Amounts accrued and unpaid for all grants under the plan totaled \$10.4 million and \$13.1 million as of March 31, 2013 and December 31, 2012, respectively.

**12. Workers Compensation Expense**

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

	Three Months Ended March 31, 2013	2012
	(In thousands)	
Service cost	\$ 505	\$ 968
Interest cost	656	680
Net amortization	235	277
Total occupational disease	1,396	1,925

Edgar Filing: ARCH COAL INC - Form 10-Q

Traumatic injury claims and assessments		7,358		5,176
Total workers compensation expense	\$	8,754	\$	7,101

**13. Employee Benefit Plans**

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

Table of Contents

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(In thousands)</b>	
Service cost	\$ 7,700	\$ 7,596
Interest cost	3,926	3,980
Expected return on plan assets	(5,806)	(5,538)
Amortization of prior service credits	(158)	(36)
Amortization of other actuarial losses	4,551	3,571
Net benefit cost	\$ 10,213	\$ 9,573

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

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(In thousands)</b>	
Service cost	\$ 556	\$ 549
Interest cost	431	491
Amortization of prior service credits	(2,750)	(2,995)
Amortization of other actuarial losses (gains)	77	(90)
Net benefit credit	\$ (1,686)	\$ (2,045)

**14. Earnings (Loss) Per Common Share**

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

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(In thousands)</b>	
Weighted average shares outstanding:		
Basic weighted average shares outstanding	212,062	211,687
Effect of common stock equivalents under incentive plans		221
Diluted weighted average shares outstanding	212,062	211,908

The effect of options, restricted stock and restricted stock units equaling 8.6 million and 3.0 million shares of common stock were excluded from the calculation of diluted weighted average shares outstanding for the three month periods ended March 31, 2013 and 2012, respectively, because the exercise price or grant price of the securities exceeded the average market price of the Company's common stock for these periods. The weighted average share impact of options, restricted stock and restricted stock units that were excluded from the calculation of weighted average shares due to the Company's incurring a net loss for the three months ended March 31, 2013 were not significant.

Table of Contents

**15. Commitments and Contingencies**

Allegheny Energy Supply ( Allegheny ), the sole customer of coal produced at the Company's subsidiary Wolf Run Mining Company's ( Wolf Run ) Sycamore No. 2 mine, filed a lawsuit against Wolf Run, Hunter Ridge Holdings, Inc. ( Hunter Ridge ), and ICG in state court in Allegheny County, Pennsylvania on December 28, 2006, and amended its complaint on April 23, 2007. Allegheny claimed that Wolf Run breached a coal supply contract when it declared force majeure under the contract upon idling the Sycamore No. 2 mine in the third quarter of 2006, and that Wolf Run continued to breach the contract by failing to ship in volumes referenced in the contract. The Sycamore No. 2 mine was idled after encountering adverse geologic conditions and abandoned gas wells that were previously unidentified and unmapped. After extensive searching for gas wells and rehabilitation of the mine, it was re-opened in 2007, but with notice to Allegheny that it would necessarily operate at reduced volumes in order to safely and effectively avoid the many gas wells within the reserve. The amended complaint also alleged that the production stoppages constitute a breach of the guarantee agreement by Hunter Ridge and breach of certain representations made upon entering into the contract in early 2005. Allegheny voluntarily dropped the breach of representation claims later. Allegheny claimed that it would incur costs in excess of \$100 million to purchase replacement coal over the life of the contract. ICG, Wolf Run and Hunter Ridge answered the amended complaint on August 13, 2007, disputing all of the remaining claims.

On November 3, 2008, ICG, Wolf Run and Hunter Ridge filed an amended answer and counterclaim against the plaintiffs seeking to void the coal supply agreement due to, among other things, fraudulent inducement and conspiracy. On September 23, 2009, Allegheny filed a second amended complaint alleging several alternative theories of liability in its effort to extend contractual liability to ICG, which was not a party to the original contract and did not exist at the time Wolf Run and Allegheny entered into the contract. No new substantive claims were asserted. ICG answered the second amended complaint on October 13, 2009, denying all of the new claims. ICG's counterclaim was dismissed on motion for summary judgment entered on May 11, 2010. Allegheny's claims against ICG were also dismissed by summary judgment, but the claims against Wolf Run and Hunter Ridge were not. The court conducted a non-jury trial of this matter beginning on January 10, 2011 and concluding on February 1, 2011. At the trial, Allegheny presented its evidence for breach of contract and claimed that it is entitled to past and future damages in the aggregate of between \$228.0 million and \$377.0 million. Wolf Run and Hunter Ridge presented their defense of the claims, including evidence with respect to the existence of force majeure conditions and excuse under the contract and applicable law. Wolf Run and Hunter Ridge presented evidence that Allegheny's damage calculations were significantly inflated because they were not determined as of the time of the breach and, in some instances, artificially assumed future non-delivery or did not take into account the apparent requirement to supply coal in the future. On May 2, 2011, the trial court entered a Memorandum and Verdict determining that Wolf Run had breached the coal supply contract and that the performance shortfall was not excused by force majeure. ICG and Allegheny filed post-verdict motions in the trial court and on August 23, 2011, the court denied the parties' motions. The court entered a final judgment on August 25, 2011, in the amount of \$104.1 million, which included pre-judgment interest. The parties appealed the lower court's decision to the Superior Court of Pennsylvania. Wolf Run and Hunter Ridge have filed an appeal bond in the amount of \$124.9 million. On August 13, 2012, the Superior Court of Pennsylvania ruled that the lower court should have calculated damages as of the date of breach, and remanded the matter back to the lower court with instructions to recalculate the award. This ruling resulted in a reduction of the Company's best estimate of the probable loss related to this lawsuit. On November 19, 2012, Allegheny filed a Petition for Allowance of Appeal with the Supreme Court of Pennsylvania and Wolf Run and Hunter Ridge filed an Answer. This Petition is pending.

In addition, the Company is a party to numerous claims and lawsuits with respect to various matters. The Company provides for costs related to contingencies when a loss is probable and the amount is reasonably determinable. As of March 31, 2013 and December 31, 2012, the Company had accrued \$32.7 million and \$32.8 million, respectively, for all legal matters, including \$4.0 million and \$4.4 million classified as current. The ultimate resolution of any such legal matter could result in outcomes which may be materially different from amounts the Company has accrued for such matters.

**16. Segment Information**

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

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

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

### Table of Contents

Operating segment results for the three months ended March 31, 2013 and 2012 are presented below. Results for the reportable segments include all direct costs of mining, including all depreciation, depletion and amortization related to the mining operations, even if the assets are not recorded at the operating segment level. Corporate, Other and Eliminations includes these charges, as well as the change in fair value of coal derivatives and coal trading activities, net; corporate overhead; land management; other support functions; and the elimination of intercompany transactions.

The asset amounts below represent an allocation of assets consistent with the basis used for the Company's incentive compensation plans. The amounts in Corporate, Other and Eliminations represent primarily corporate assets (cash, receivables, investments, plant, property and equipment) as well as unassigned coal reserves, above-market acquired sales contracts and other unassigned assets. Goodwill is allocated to the respective reporting units, even though it may not be reflected in the subsidiaries' financial statements. Prior year asset amounts have been restated to reflect a change in how certain unassigned coal reserves and goodwill amounts are presented.

	PRB	APP	WBIT (in thousands)	Other Operating Segments	Corporate, Other and Eliminations	Consolidated
<b>Three months ended March 31, 2013</b>						
Revenues	\$ 361,946	\$ 282,618	\$ 155,644	\$ 25,294	\$	\$ 825,502
Income (loss) from operations	15,515	(27,117)	24,951	1,435	(47,213)	(32,429)
Depreciation, depletion and amortization	42,227	55,331	17,371	2,609	1,330	118,868
Amortization of acquired sales contracts, net	(1,199)	(2,472)		861		(2,810)
Total assets	1,939,892	4,334,324	623,243	159,090	2,863,595	9,920,144
Capital expenditures	2,157	49,296	1,502	482	1,085	54,522
<b>Three months ended March 31, 2012</b>						
Revenues	\$ 401,177	\$ 469,058	\$ 144,559	\$ 24,857	\$	\$ 1,039,651
Income (loss) from operations	32,543	15,835	31,241	(3,750)	(21,788)	54,081
Depreciation, depletion and amortization	41,223	76,017	18,600	3,687	439	139,966
Amortization of acquired sales contracts, net	(816)	(13,088)		(113)		(14,017)
Total assets	2,263,517	4,640,344	752,197	72,382	2,436,678	10,165,118
Capital expenditures	3,986	66,303	15,137	5,644	2,201	93,271

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

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(In thousands)</b>	
Income (loss) from operations	\$ (32,429)	\$ 54,081
Interest expense	(95,087)	(74,772)
Interest and investment income	2,836	1,021
Loss before income taxes	\$ (124,680)	\$ (19,670)

**17. Supplemental Condensed Consolidating Financial Information**

Pursuant to the indentures governing Arch Coal, Inc.'s senior notes, certain wholly-owned subsidiaries of the Company have fully and unconditionally guaranteed the senior notes on a joint and several basis. The following tables present condensed consolidating financial information for (i) the Company, (ii) the issuer of the senior notes, (iii) the guarantors under the senior

Table of Contents

notes, and (iv) the entities which are not guarantors under the senior notes (Arch Receivable Company, LLC and the Company's subsidiaries outside the U.S.):



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

	Parent/Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
<b>Revenues</b>	\$	\$ 825,502	\$	\$	\$ 825,502
<b>Costs, expenses and other</b>					
Cost of sales	2,883	707,690			710,573
Depreciation, depletion and amortization	1,406	117,453	9		118,868
Amortization of acquired sales contracts, net		(2,810)			(2,810)
Change in fair value of coal derivatives and coal trading activities, net		1,308			1,308
Selling, general and administrative expenses	21,698	10,035	1,476		33,209
Other operating income, net	(5,907)	3,702	(1,012)		(3,217)
	20,080	837,378	473		857,931
Income from investment in subsidiaries	(2,871)			2,871	
Loss from operations	(22,951)	(11,876)	(473)	2,871	(32,429)
Interest expense, net:					
Interest expense	(110,827)	(6,455)	(1,041)	23,236	(95,087)
Interest and investment income	9,098	15,443	1,531	(23,236)	2,836
	(101,729)	8,988	490		(92,251)
Income (loss) before income taxes	(124,680)	(2,888)	17	2,871	(124,680)
Benefit from income taxes	(54,631)				(54,631)
Net income (loss)	(70,049)	(2,888)	17	2,871	(70,049)
Total comprehensive income (loss)	\$ (68,558)	\$ (3,324)	\$ 17	\$ 3,307	\$ (68,558)

Table of Contents**Condensed Consolidating Statements of Operations****Three Months Ended March 31, 2012**

	Parent/Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
<b>Revenues</b>	\$	\$ 1,039,651	\$	\$	\$ 1,039,651
<b>Costs, expenses and other</b>					
Cost of sales	2,967	847,904			850,871
Depreciation, depletion and amortization	1,216	138,744	6		139,966
Amortization of acquired sales contracts, net		(14,017)			(14,017)
Change in fair value of coal derivatives and coal trading activities, net		(3,613)			(3,613)
Selling, general and administrative expenses	18,644	9,637	2,580		30,861
Other operating income, net	(3,111)	(3,027)	(12,360)		(18,498)
	19,716	975,628	(9,774)		985,570
Income from investment in subsidiaries	77,315			(77,315)	
Income from operations	57,599	64,023	9,774	(77,315)	54,081
Interest expense, net:					
Interest expense	(82,097)	(11,484)	(1,038)	19,847	(74,772)
Interest and investment income	4,828	14,128	1,912	(19,847)	1,021
	(77,269)	2,644	874		(73,751)
Income (loss) before income taxes	(19,670)	66,667	10,648	(77,315)	(19,670)
Provision for (benefit from) income taxes	(22,660)		1,581		(21,079)
Net income	2,990	66,667	9,067	(77,315)	1,409
Less: Net income attributable to noncontrolling interest	(203)				(203)
Net income attributable to Arch Coal, Inc.	\$ 2,787	\$ 66,667	\$ 9,067	\$ (77,315)	\$ 1,206
Total comprehensive income	\$ 8,709	\$ 68,111	\$ 9,067	\$ (77,178)	\$ 8,709

Table of Contents**Condensed Consolidating Balance Sheets**

March 31, 2013

	Non-Guarantor				
	Parent/Issuer	Guarantor Subsidiaries	Subsidiaries	Eliminations	Consolidated
<b>Assets</b>					
Cash and cash equivalents	\$ 597,308	\$ 120,429	\$ 12,382	\$	\$ 730,119
Restricted cash	2,290				2,290
Short term investments	248,414				248,414
Receivables	50,179	36,477	263,123	(4,735)	345,044
Inventories		368,240			368,240
Other	101,003	88,903	369		190,275
Total current assets	999,194	614,049	275,874	(4,735)	1,884,382
Property, plant and equipment, net	26,716	7,245,761	64		7,272,541
Investment in subsidiaries	8,259,302			(8,259,302)	
Intercompany receivables	(1,389,356)	1,637,093	(247,737)		
Note receivable from Arch Western	675,000			(675,000)	
Other	184,571	578,560	90		763,221
Total other assets	7,729,517	2,215,653	(247,647)	(8,934,302)	763,221
Total assets	\$ 8,755,427	\$ 10,075,463	\$ 28,291	\$ (8,939,037)	\$ 9,920,144
<b>Liabilities and Stockholders Equity</b>					
Accounts payable	\$ 27,269	\$ 201,925	\$ 75	\$	\$ 229,269
Accrued expenses and other current liabilities	105,059	251,850	509	(4,735)	352,683
Current maturities of debt	26,218	2,088			28,306
Total current liabilities	158,546	455,863	584	(4,735)	610,258
Long-term debt	5,059,611	22,594			5,082,205
Note payable to Arch Coal		675,000		(675,000)	
Asset retirement obligations	1,672	409,303			410,975
Accrued pension benefits	34,595	34,747			69,342
Accrued postretirement benefits other than pension	14,486	31,927			46,413
Accrued workers compensation	24,032	57,007			81,039
Deferred income taxes	610,195				610,195
Other noncurrent liabilities	69,936	157,210	217		227,363
Total liabilities	5,973,073	1,843,651	801	(679,735)	7,137,790
Stockholders equity	2,782,354	8,231,812	27,490	(8,259,302)	2,782,354
Total liabilities and stockholders equity	\$ 8,755,427	\$ 10,075,463	\$ 28,291	\$ (8,939,037)	\$ 9,920,144

Table of Contents**Condensed Consolidating Balance Sheets**

December 31, 2012

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>Assets</b>					
Cash and cash equivalents	\$ 671,313	\$ 100,468	\$ 12,841	\$	\$ 784,622
Restricted cash	3,453				3,453
Short term investments	234,305				234,305
Receivables	49,281	40,452	247,171	(4,824)	332,080
Inventories		365,424			365,424
Other	106,786	86,877	557		194,220
Total current assets	1,065,138	593,221	260,569	(4,824)	1,914,104
Property, plant and equipment, net	27,476	7,309,550	72		7,337,098
Investment in subsidiaries	8,254,508			(8,254,508)	
Intercompany receivables	(1,367,739)	1,600,311	(232,572)		
Note receivable from Arch Western	675,000			(675,000)	
Other	187,171	568,314	90		755,575
Total other assets	7,748,940	2,168,625	(232,482)	(8,929,508)	755,575
Total assets	\$ 8,841,554	\$ 10,071,396	\$ 28,159	\$ (8,934,332)	\$ 10,006,777
<b>Liabilities and Stockholders Equity</b>					
Accounts payable	\$ 19,859	\$ 204,370	\$ 189	\$	\$ 224,418
Accrued expenses and other current liabilities	65,293	259,162	124	(4,824)	319,755
Current maturities of debt	32,054	842			32,896
Total current liabilities	117,206	464,374	313	(4,824)	577,069
Long-term debt	5,061,925	23,954			5,085,879
Note payable to Arch Coal		675,000		(675,000)	
Asset retirement obligations	1,646	408,059			409,705
Accrued pension benefits	33,456	34,174			67,630
Accrued postretirement benefits other than pension	13,953	31,133			45,086
Accrued workers compensation	25,323	56,306			81,629
Deferred income taxes	664,182				664,182
Other noncurrent liabilities	69,296	151,360	374		221,030
Total liabilities	5,986,987	1,844,360	687	(679,824)	7,152,210
Stockholders equity	2,854,567	8,227,036	27,472	(8,254,508)	2,854,567
Total liabilities and stockholders equity	\$ 8,841,554	\$ 10,071,396	\$ 28,159	\$ (8,934,332)	\$ 10,006,777

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

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

Table of Contents**Condensed Consolidating Statements of Cash Flows****Three Months Ended March 31, 2012**

	<b>Parent/Issuer</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Cash provided by (used in) operating activities	\$ (39,702)	\$ 19,456	\$ 75,236	\$	\$ 54,990
Investing Activities					
Change in restricted cash	1,455				1,455
Capital expenditures	(1,177)	(92,094)			(93,271)
Proceeds from dispositions of property, plant and equipment		608	21,497		22,105
Investments in and advances to affiliates	(3,619)	(3,488)		1,330	(5,777)
Minimum royalty payments		(8,262)			(8,262)
Cash provided by (used in) investing activities	(3,341)	(103,236)	21,497	1,330	(83,750)
Financing Activities					
Contributions from parent		1,330		(1,330)	
Net increase (decrease) in borrowings under lines of credit	50,000		(16,000)		34,000
Net payments from other debt	(5,993)	(1,330)			(7,323)
Debt financing costs	(54)		(46)		(100)
Dividends paid	(23,327)				(23,327)
Issuance of common stock under incentive plans	5,131				5,131
Transactions with affiliates, net	(14,060)	84,037	(69,977)		
Cash provided by (used in) financing activities	11,697	84,037	(86,023)	(1,330)	8,381
Increase (decrease) in cash and cash equivalents	(31,346)	257	10,710		(20,379)
Cash and cash equivalents, beginning of period	66,542	70,258	1,349		138,149
Cash and cash equivalents, end of period	\$ 35,196	\$ 70,515	\$ 12,059	\$	\$ 117,770

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

Global coal markets showed continued weakness in the first quarter of 2013, impacting our results for the period in both sales volumes and pricing. International thermal markets are not showing signs of near-term improvement and we expect thermal coal exports to taper off during the remainder of 2013. We expect industry-wide coal exports to be less than 2012 levels, but still high by historical standards, as we are expecting metallurgical coal export activity to remain strong, led by demand in Asia and Latin America. Our export volumes of 2.7 million tons in the first quarter of 2013 were comparable to the levels shipped in the first quarter of 2012, with metallurgical coal exports increasing and thermal coal exports decreasing.

At the same time, several trends relating to the domestic thermal coal markets are improving. First, 2013 power demand increased more than 3% through March 2013 compared with a 4% decline during the same period in 2012. In addition, coal consumption by electricity producers grew more than 10% during the first quarter of 2013, after having fallen by 20% in the first quarter of 2012. Higher natural gas prices, which have more than doubled over what they were a year ago, and cool spring weather have contributed to the stronger power demand and coal consumption trends. These trends should continue to correct the significant coal stockpile levels that were built during 2012, particularly in the PRB and Western Bituminous regions. However, we expect Appalachian coal demand will continue to be weak unless natural gas prices rise further and we currently project that production in that region to fall further in 2013.

During the current market downturn, management has continued to focus on capital spending reductions, cost containment and efficiency efforts and working capital and liquidity management to improve cash flows and prepare the company to capitalize on opportunities when coal markets recover.

**Operational results**

The following table shows results by operating segment for the three months ended March 31, 2013 and compares it with the information for the three months ended March 31, 2012:

	Three Months Ended March 31,		Increase (Decrease)	
	2013	2012	\$	%
<i>Powder River Basin</i>				
Tons sold (in thousands)	26,612	27,215	(603)	(2.2)%
Coal sales realization per ton sold(1)	\$ 12.68	\$ 13.87	\$ (1.19)	(8.6)%
Cost per ton sold	\$ 12.24	\$ 12.72	\$ (0.48)	(3.8)%
Operating margin per ton sold(2)	\$ 0.44	\$ 1.15	\$ (0.71)	(61.7)%
Adjusted EBITDA(3) (in thousands)	\$ 56,780	\$ 74,194	\$ (17,414)	(23.5)%
<i>Appalachia</i>				
Tons sold (in thousands)	3,387	4,666	(1,279)	(27.4)%
Coal sales realization per ton sold(1)	\$ 74.76	\$ 88.68	\$ (13.92)	(15.7)%

Edgar Filing: ARCH COAL INC - Form 10-Q

Cost per ton sold	\$	82.76	\$	82.15	\$	0.61	0.7%
Operating margin (loss) per ton sold(2)	\$	(8.00)	\$	6.53	\$	(14.53)	(222.5)%
Adjusted EBITDA(3) (in thousands)	\$	25,702	\$	80,442	\$	(54,740)	(68.0)%
<i>Western Bituminous</i>							
Tons sold (in thousands)		3,508		3,261		247	7.6%
Coal sales realization per ton sold(1)	\$	35.53	\$	36.77	\$	(1.24)	(3.4)%
Cost per ton sold	\$	29.07	\$	26.98	\$	2.09	7.7%
Operating margin per ton sold(2)	\$	6.46	\$	9.79	\$	(3.33)	(34.0)%
Adjusted EBITDA(3) (in thousands)	\$	42,310	\$	50,803	\$	(8,493)	(16.7)%

(1) These per-ton measurements reflect adjustments to numbers reported under U.S. GAAP to reflect the complete results we achieved within our operating segments. Since other companies may calculate these per ton amounts differently, our calculation may not be comparable to similarly titled measures used by those companies.

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



Table of Contents

(3) Adjusted EBITDA is defined as net income attributable to the Company before the effect of net interest expense, income taxes, depreciation, depletion and amortization and the amortization of acquired sales contracts. Adjusted EBITDA may also be adjusted for items that may not reflect the trend of future results. Segment Adjusted EBITDA is reconciled to net income at the end of this Results of Operations section.

*Powder River Basin* Segment Adjusted EBITDA decreased in the first quarter of 2013 when compared to the first quarter of 2012, due to the weak coal market conditions, which resulted in lower coal realizations on contracted, market-based and export tons in the first quarter of 2013, as well as lower sales volumes. Lower selling prices were partially offset by a decrease in per-ton costs, which decreased 4% despite the lower volume levels, due to cost control efforts and a decrease in taxes and royalties that fluctuate with selling prices (\$0.29 per ton).

*Appalachia* Segment Adjusted EBITDA decreased in the first quarter of 2013 when compared to the first quarter of 2012, due to the weak coal market conditions, resulting in lower sales volumes and lower pricing, particularly on metallurgical coal sales. We sold 1.7 million tons of metallurgical-quality coal in 2013 compared to 1.6 million tons in 2012. Per-ton costs decreased slightly despite a substantial decrease in sales volumes due to the impact of idling higher-cost mining operations in 2012, cost containment and efficiency efforts, as well as lower taxes and royalties that fluctuate with selling prices (\$2.18 per ton).

*Western Bituminous* Segment Adjusted EBITDA decreased from 2012 due to lower per-ton sales realizations and lower production volumes, which resulted in an increase in per-ton costs. While sales volumes increased in the first quarter of 2013 when compared to the first quarter of 2012, production volumes were lower, due to the completion of longwall mining at the Dugout Canyon mine in December 2012.

**Reconciliation to amounts reported in statement of operations**

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
Transportation costs netted against per-ton realizations to reflect netback price to the region		
Powder River Basin	\$ 0.92	\$ 0.87
Appalachia	\$ 8.40	\$ 10.77
Western Bituminous	\$ 10.70	\$ 11.51
API-2 risk management position settlements included in per-ton realizations not classified as coal sales revenues in statement of operations		
Appalachia	\$ 0.79	\$ 0.45
Western Bituminous	\$ 1.86	\$ 0.30
Diesel risk management position settlements not classified as cost of coal sales in statement of operations		
Powder River Basin	\$ 0.14	\$
Appalachia	\$ 0.30	\$

**Results of Operations**

*Three Months Ended March 31, 2013 Compared to Three Months Ended March 31, 2012*

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

*Summary.* Our results during the first quarter of 2013 when compared to the first quarter of 2012 were impacted by continuing weak market conditions.

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

The following table compares information about coal sales during the three months ended March 31, 2013 with the information for the three months ended March 31, 2012:

	Three Months Ended March 31,		Increase (Decrease)	
	2013	2012	Amount	%
	(Amounts in thousands, except per ton data and percentages)			
Coal sales	\$ 824,618	\$ 1,037,140	\$ (212,522)	(20.5)%
Tons sold	34,050	35,660	(1,610)	(4.5)%

Coal sales decreased approximately 20% in the first quarter of 2013 from the first quarter of 2012, due to lower sales volumes and realized prices. Lower sales volumes, primarily the result of weak domestic and international thermal coal

Table of Contents

markets, reduced revenues by approximately \$125 million. Lower average realizations per ton sold, the result of lower pricing on both thermal and metallurgical quality coal sales due to the weak coal markets and a lower percentage of higher-priced thermal coal sales out of Appalachia, resulted in a decrease in revenues of approximately \$87 million.

*Costs, expenses and other.* The following table compares costs, expenses and other components of operating income for the three months ended March 31, 2013 with the information for the three months ended March 31, 2012:

Cost of sales (exclusive of items shown separately below)	\$	710,573	\$	850,871	\$	140,298
Depreciation, depletion and amortization		118,868		139,966		21,098
Amortization of acquired sales contracts, net		(2,810)		(14,017)		(11,207)
Change in fair value of coal derivatives and coal trading activities, net		1,308		(3,613)		(4,921)
Selling, general and administrative expenses		33,209		30,861		(2,348)
Other operating income, net		(3,217)		(18,498)		(15,281)
Total costs, expenses and other	\$	857,931	\$	985,570	\$	127,639

*Cost of sales.* Our cost of sales decreased in the first quarter of 2013 from the first quarter of 2012, primarily due to the decrease in sales volumes (\$95 million) and lower per-ton average production costs, (\$33 million), which are discussed in detail in the Operational results section. In addition, transportation costs decreased \$12 million to \$108 million in the first quarter of 2013, compared to the first quarter of 2012.

*Depreciation, depletion and amortization.* When compared with the first quarter of 2012, depreciation, depletion and amortization costs decreased in the first quarter of 2013 due to the decreases in production for the respective periods, including the impact of mine closures in 2012.

*Change in fair value of coal derivatives and coal trading activities, net.* The gains reflected in 2012 relate primarily to positions in the API-2 market, the derivatives market for coal delivered into Europe. We entered into these positions to manage price risk on physical export sales into Europe. As these positions are not accounted for as hedges, changes in the positions fair value prior to settlement is recognized in the condensed consolidated statement of operations. When the positions settle, the realized gains and losses are reclassified to other operating income, net.

*Selling, general and administrative expenses.* Selling, general and administrative expenses in the first quarter of 2013 increased when compared with the first quarter of 2012 primarily due to a reduction in the bonus accrual in the first quarter of 2012 of \$3.8 million relating to ICG employees (nearly all of which was offset by an increase in the accrual in cost of sales) and an increase in costs relating to the deferred compensation plan of \$0.9 million. These factors were offset by a decrease in stock compensation expense of \$1.3 million, as current grants have a lower fair value than previous grants, and other expense reductions, primarily from cost containment efforts.

*Other operating income, net.* When compared with the first quarter of 2012, the decrease in other operating income, net for the first quarter of 2013 was primarily the result of liquidated damages we incurred under throughput commitments of \$10.5 million and a gain of \$12.5 million recognized in the first quarter of 2012 on the sale of non-core business assets. These were partially offset by gains on settlements on coal

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

derivatives of \$9.2 million in the first quarter of 2013, an increase of \$6.1 million from the first quarter of 2012. Although these coal derivative positions are for the purpose of managing our risk to changing prices, they are not accounted for as hedges, and the realized amounts are reclassified here from Change in fair value of coal derivatives and coal trading activities, net .

*Net interest expense.* The following table summarizes our net interest expense for the three months ended March 31, 2013 and compares it with the information for the three months ended March 31, 2012:

Table of Contents

	Three Months Ended March 31,		Increase (Decrease)	
	2013	2012	\$	%
	(Amounts in thousands, except percentages)			
Interest expense	\$ (95,087)	\$ (74,772)	\$ (20,315)	(27.2)%
Interest and investment income	2,836	1,021	1,815	177.8%
	\$ (92,251)	\$ (73,751)	\$ (18,500)	(25.1)%

The increase in interest expense is due to an increase in our outstanding debt in the first quarter of 2013 when compared with the first quarter of 2012, primarily as a result of the financing transactions during 2012, which resulted in a net increase in debt outstanding of over \$1 billion.

*Income taxes.* Our effective income tax rate is sensitive to changes in and the relationship between annual profitability and the deduction for percentage depletion. The increase in the income tax benefit is primarily the result of an increase in our reported losses for the first quarter of 2013 when compared to the first quarter of 2012.

	Three Months Ended March 31,	2012	Increase
	2013	(In thousands)	In Net Income
			\$
Benefit from income taxes	(54,631)	(21,079)	33,552

***Reconciliation of Segment Adjusted EBITDA to Net Income***

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

	Three Months Ended March 31,	
	2013	2012
Reported Segment Adjusted EBITDA	\$ 124,792	\$ 205,439
Corporate and other(1)	(41,163)	(25,612)
Adjusted EBITDA	83,629	179,827
Income tax expense (benefit)	54,631	21,079
Interest expense, net	(92,251)	(73,751)
Depreciation, depletion and amortization	(118,868)	(139,966)
Amortization of acquired sales contracts, net	2,810	14,017
Net income (loss) attributable to Arch Coal	\$ (70,049)	\$ 1,206

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

**Liquidity and Capital Resources**

Our primary sources of cash are coal sales to customers, borrowings under our credit facilities and other financing arrangements, and debt and equity offerings related to significant transactions or refinancing activity. Excluding any significant mineral reserve acquisitions, we generally satisfy our working capital requirements and fund capital expenditures and debt-service obligations with cash generated from operations, cash on hand or borrowings under our lines of credit. Such plans are subject to change based on our cash needs. Availability under our sources of liquidity, including cash and short-term investments totaled \$1.3 billion at March 31, 2013.

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

### Table of Contents

There were no borrowings under lines of credit during the three months ended March 31, 2013. Our average borrowing level under lines of credit was approximately \$492 million for the three months ended March 31, 2012.

The following is a summary of cash provided by or used in each of the indicated types of activities during the three months ended March 31, 2013 and March 31, 2012:

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(Dollars in thousands)</b>	
<b>Cash provided by (used in):</b>		
Operating activities	\$ 43,291	\$ 54,990
Investing activities	(81,338)	(83,750)
Financing activities	(16,456)	8,381

Cash provided by operating activities decreased in the first quarter of 2013 compared to the first quarter of 2012, driven by the decrease in our profitability resulting from weak coal market conditions, largely offset by a decrease in cash invested in working capital.

Cash used in investing activities was consistent between the first quarter of 2013 and the first quarter of 2012. Capital expenditures decreased approximately \$38.7 million during the three months ended March 31, 2013 when compared with the three months ended March 31, 2012 due to cash conservation efforts. We spent approximately \$49 million during the three months ended March 31, 2013 on the development of the Leer mine. Proceeds from dispositions of property, plant and equipment decreased by \$21.4 million for the same periods. We purchased short term investments of \$26.8 million in 2013, offset by proceeds from the sales of short term investments of \$11.5 million.

Cash used in financing activities was approximately \$16.5 million in the first quarter of 2013, compared to cash provided by financing activities of approximately \$8.4 million in the first quarter of 2012. There were no borrowings under lines of credit during the three months ended March 31, 2013, while we borrowed \$34 million under our accounts receivable securitization program during the three months ended March 31, 2012. The decrease in the dividend rate in the second quarter of 2012 from \$0.11 to \$0.03 reduced dividends paid \$17.0 million to \$6.4 million during the first quarter of 2013 compared to the first quarter of 2012.

### **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>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
Ratio of earnings to combined fixed charges and preference dividends(1)	N/A(2)	0.74x

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

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

(2) Total losses for the ratio calculation were \$27.9 million and total fixed charges were \$101.6 million for the three months ended March 31, 2013

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

We manage our commodity price risk for our non-trading, thermal coal sales through the use of long-term coal supply agreements, and to a limited extent, through the use of derivative instruments. Sales commitments in the metallurgical coal market are typically not long-term in nature, and we are therefore subject to the fluctuations in the market pricing. We expect to sell a total of approximately 8 million to 9 million tons of metallurgical coal in 2013.

Our commitments for 2013 and 2014 are as follows:



Edgar Filing: ARCH COAL INC - Form 10-Q

Table of Contents

	2013		2014	
	Tons	\$ per ton	Tons	\$ per ton
<b><u>Powder River Basin</u></b>				
Committed, Priced	94.3	\$ 13.13	52.6	\$ 14.18
Committed, Unpriced	7.1		14.6	
<b><u>Western Bituminous</u></b>				
Committed, Priced	12.7	\$ 37.38	8.2	\$ 40.69
Committed, Unpriced	1.4		0.2	
<b><u>Appalachia</u></b>				
Committed, Priced Thermal	6.4	\$ 63.95	1.7	\$ 53.98
Committed, Unpriced Thermal	0.2		0.3	
Committed, Priced Metallurgical	6.1	\$ 91.01		\$
Committed, Unpriced Metallurgical	0.4			
<b><u>Illinois Basin</u></b>				
Committed, Priced	2.1	\$ 42.50	1.7	\$ 42.33

We are also exposed to commodity price risk in our coal trading activities, which represents the potential future loss that could be caused by an adverse change in the market value of coal. Our coal trading portfolio included forward, swap and put and call option contracts at March 31, 2013. The estimated future realization of the value of the trading portfolio is \$4.1 million of losses in the remainder of 2013 and \$3.6 million of gains in 2014.

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

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

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 three months ended March 31, 2013, VaR for our coal trading positions that are recorded at fair value through earnings ranged from under \$0.1 million to \$0.5 million. The linear mean of each daily VaR was \$0.2 million. The final VaR at March 31, 2013 was \$0.1 million.

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

We are exposed to fluctuations in the fair value of coal derivatives that we enter into to manage the price risk related to future coal sales, but for which we do not elect hedge accounting. Any gains or losses on these derivative instruments would be offset in the pricing of the physical coal sale. During the three months ended March 31, 2013 VaR for our risk management positions that are recorded at fair value through earnings ranged from under \$0.6 million to \$1.1 million. The linear mean of each daily VaR was \$0.9 million. The final VaR at March 31, 2013 was \$0.9 million.

We are also exposed to the risk of fluctuations in cash flows related to our purchase of diesel fuel. We expect to use approximately 57 to 67 million gallons of diesel fuel for use in our operations during 2013. We enter into forward physical purchase contracts, as well as purchased heating oil options, to reduce volatility in the price of diesel fuel for our operations. At March 31, 2013, we had protected the price of approximately 97% of our expected purchases for the remainder of 2013 and 42% of our 2014 purchases. At March 31, 2013, we had purchased heating oil call options for approximately 71 million gallons for the purpose of managing the price risk associated with future diesel purchases. We also purchase heating oil call options

Table of Contents

manage the price risk associated with fuel surcharges on barge and rail shipments, which cover increases in diesel fuel prices. At March 31, 2013, we held purchased call options for approximately 11 million gallons for the purpose of managing the fluctuations in cash flows associated with fuel surcharges on future shipments. These positions reduce our risk of cash flow fluctuations related to these surcharges but the positions are not accounted for as hedges. A \$0.25 per gallon decrease in the price of heating oil would not result in an increase in our expense related to the heating oil derivatives.

We are exposed to market risk associated with interest rates due to our existing level of indebtedness. At March 31, 2013, of our \$5.1 billion principal amount of debt outstanding, approximately \$1.7 billion of outstanding borrowings have interest rates that fluctuate based on changes in the market rates. An increase in the interest rates related to these borrowings of 25 basis points would not result in an annualized increase in interest expense based on interest rates in effect at March 31, 2013.

**Item 4. Controls and Procedures.**

We performed an evaluation under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2013. Based on that evaluation, our management, including our chief executive officer and chief financial officer, concluded that the disclosure controls and procedures were effective as of such date. There were no changes in our internal control over financial reporting during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

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

**Permit Litigation Matters**

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

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

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

In February 2009, the Fourth Circuit reversed the District Court. The Fourth Circuit held that the Corps' jurisdiction under Section 404 of the Clean Water Act is limited to the narrow issue of the filling of jurisdictional waters. The court also held that the Corps' findings of no significant impact under the National Environmental Policy Act and no significant degradation under the Clean Water Act are entitled to deference. Such findings entitle the Corps to avoid preparing an environmental impact statement, the absence of which was one issue on appeal. These holdings also validated the type of

Table of Contents

mitigation projects proposed by our operations to minimize impacts and comply with the relevant statutes. Finally, the Fourth Circuit found that stream segments, together with the sediment ponds to which they connect, are unitary waste treatment systems, not waters of the United States, and that the Corps had not exceeded its authority in permitting them.

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

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

On October 15, 2010, the United States moved to extend the existing stay for an additional 120 days (until February 22, 2011) while the EPA Administrator reviewed the Recommended Determination issued by the EPA Region 3. By Memorandum Opinion and Order dated November 2, 2010, the court granted the United States' motion. On January 13, 2011, the EPA issued its Final Determination to withdraw the specification of two of the three watersheds as a disposal site for dredged or fill material approved under the current Section 404 permit. The court was notified of the Final Determination and by order dated March 21, 2011 stayed further proceedings in the case until further order of the court, in light of the challenge to the EPA's Final Determination then pending in federal court in Washington, DC. In a Memorandum and Opinion and separate Order, each dated March 23, 2012, the federal court granted Mingo Logan's motion for summary judgment, vacated the EPA's Final Determination and found valid and in full force Mingo Logan's Section 404 permit. As described more fully below, the EPA appealed that order to the United States Court of Appeals for the District of Columbia Circuit and by Opinion of the Court dated April 23, 2013, the court reversed the lower court's order and remanded the matter to the district court for further proceedings.

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

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

By letter of September 3, 2009, the EPA asked the Corps of Engineers to suspend, revoke or modify the existing permit it issued in January 2007 to Mingo Logan under Section 404 of the Clean Water Act, claiming that new information and circumstances have arisen which justify reconsideration of the permit. By letter of September 30, 2009, the Corps of Engineers advised the EPA that it would not reconsider its decision to issue the permit. By letter of October 16, 2009, the EPA advised the Corps that it has reason to believe that the Mingo Logan mine will have unacceptable adverse impacts to fish and wildlife resources and that it intends to issue a public notice of a proposed determination to restrict or prohibit discharges of fill material that already are approved by the Corps permit. By federal register publication dated April 2, 2010, the EPA issued its Proposed Determination to Prohibit, Restrict or Deny the Specification, or the Use for Specification of an Area as a Disposal Site:

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

Spruce No. 1 Surface Mine, Logan County, WV pursuant to Section 404(c) of the Clean Water Act, the EPA accepted written comments on its proposed action (sometimes known as a veto proceeding ), through June 4, 2010 and conducted a public hearing, as well, on May 18, 2010. We submitted comments on the action during this period. On September 24, 2010, the EPA Region 3 issued a Recommended Determination to the EPA Administrator recommending that the EPA prohibit the placement of fill material in two of the three watersheds for which filling is approved under the current Section 404 permit. Mingo Logan, along with the Corps, West Virginia DEP and the mineral owner, engaged in a consultation with the EPA as required by the regulations, to discuss corrective action to address the unacceptable adverse effects identified. On January 13, 2011, the EPA issued its Final Determination pursuant to Section 404(c) of the Clean Water Act to withdraw the specification of two of the three watersheds approved in the current Section 404 permit as a disposal site for dredged or fill material. By separate action, Mingo Logan sued the EPA on April 2, 2010 in federal court in Washington, D.C. seeking a ruling that the EPA has no authority under the Clean Water Act to veto a previously issued permit (Mingo Logan Coal Company, Inc. v. USEPA, No. 1:10-cv-00541(D.D.C.)). The EPA moved to dismiss that action, and we responded to that motion.

Table of Contents

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

On May 11, 2012, the EPA filed a notice of appeal to the United States Court of Appeals for the District of Columbia Circuit. The court heard oral arguments on March 14, 2013. By Opinion of the Court filed on April 23, 2013, the court reversed the district court on the threshold issue and remanded the matter to the district court to address the merits of our APA challenge to the Final Determination.

**Allegheny Energy Contract Matter**

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

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

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

At the trial, Allegheny presented its evidence for breach of contract and claimed that it is entitled to past and future damages in the aggregate of between \$228 million and \$377 million. Wolf Run and Hunter Ridge presented their defense of the claims, including evidence with respect to the existence of force majeure conditions and excuse under the contract and applicable law. Wolf Run and Hunter Ridge presented evidence that Allegheny's damages calculations were significantly inflated because it did not seek to determine damages as of the time of the breach and in some instances artificially assumed future nondelivery or did not take into account the apparent requirement to supply coal in the future. On

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

May 2, 2011, the trial court entered a Memorandum and Verdict determining that Wolf Run had breached the coal supply contract and that the performance shortfall was not excused by force majeure. The trial court awarded total damages and interest in the amount of \$104.1 million. ICG and Allegheny filed post-verdict motions in the trial court and on August 23, 2011, the court denied the parties' motions. The court entered a final judgment on August 25, 2011, in the amount of \$104.1 million, which included pre-judgment interest. The parties appealed the lower court's decision to the Superior Court of Pennsylvania. On August 13, 2012, the Superior Court of Pennsylvania ruled that the lower court should have calculated damages as of the date of breach, and remanded the matter back to the lower court with instructions to recalculate the award. On November 19, 2012, Allegheny filed a Petition for Allowance of Appeal with the Supreme Court of Pennsylvania and Wolf Run and Hunter Ridge filed an Answer. This Petition is pending.



Table of Contents

**ICG Hazard**

The Sierra Club, on December 3, 2010, filed a Notice of Intent ( NOI ) to sue ICG Hazard, LLC ( Hazard ), alleging violations of the Clean Water Act and the Surface Mining Control and Reclamation Act of 1977 at Hazard s Thunder Ridge surface mine. The NOI, which was supplemented by a revised filing on February 24, 2011, claims that Hazard is discharging selenium and contributing to conductivity levels in the receiving streams in violation of state and federal regulations. On May 24, 2011, the Sierra Club sued Hazard in U.S. District Court for the Eastern District of Kentucky under the Citizens Suit provisions of the Clean Water Act and the Surface Mining Control and Reclamation Act seeking civil penalties, injunctive relief and attorneys fees. On February 17, 2012, ICG Hazard filed a motion for summary judgment. Also on February 17, 2012, the Sierra Club filed a competing motion for summary judgment.

On September 28, 2012, the court entered a Memorandum Opinion and Order granting Hazard summary judgment on both Clean Water Act ( CWA ) and Surface Mining Control and Reclamation Act ( SMCRA ) claims finding that the CWA permit shield applies and that the SMCRA cannot be used to circumvent the CWA permit shield with respect to point source discharges. The court denied summary judgment to the extent the facts showed there were non-point source discharges from areas disturbed by surface mining activities. On October 4, 2012, the Sierra Club filed a Motion to Clarify Claims and Request Final Judgment Order notifying the court that all of its claims in the matter involved discharges from discrete point sources and that there remain no issues of law or fact that require court resolution. The court entered a final judgment on January 11, 2013. On January 22, 2013, the Sierra Club filed a notice of appeal to the United States Court of Appeals for the Sixth Circuit. The parties are currently subject to the court s briefing schedule issued on February 7, 2013.

**Patriot Coal Corporation Bankruptcy**

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

On September 20, 2012, Patriot filed a motion with the U.S. Bankruptcy Court for the Southern District of New York to reject a master coal sales agreement entered into on December 31, 2005 between us and Magnum, which was established in order to meet obligations under a coal sales agreement with a customer who did not consent to the assignment of their contract to Magnum. On December 18, 2012, the court accepted Patriot s motion to reject the master coal sales agreement. As a result of the court s decision, Arch has accrued \$58.3 million, which represents the discounted value of the remaining monthly buyout amounts under the underlying coal sales agreement.

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

In September 2006, our board of directors authorized a share repurchase program for the purchase of up to 14,000,000 shares of our common stock. There is no expiration date on the current authorization, and we have not made any decisions to suspend or cancel purchases under the program. As of March 31, 2013, there were 10,925,800 shares of our common stock available for purchase under this program. We did not purchase any shares of our common stock under this program during the quarter ended March 31, 2013. Based on the closing price of our common stock as reported on the New York Stock Exchange on May 1, 2013, the approximate dollar value of our common stock that may yet

be purchased under this program was \$53 million.

**Item 4. Mine Safety Disclosures.**

The statement concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of Regulation S-K is included in Exhibit 95 to this Quarterly Report on Form 10-Q for the period ended March 31, 2013.

Table of Contents

**Item 6. Exhibits.**

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

10.1	Arch Coal, Inc.'s Omnibus Incentive Plan
10.2	Form of Performance Unit Contract
10.3	Form of Non-Qualified Stock Option Award Agreement
10.4	Form of Restricted Stock Unit Contract
10.5	Form of Restrict Stock Unit Contract for Non-Employee Directors
12.1	Computation of ratio of earnings to combined fixed charges and preference dividends.
31.1	Rule 13a-14(a)/15d-14(a) Certification of John W. Eaves.
31.2	Rule 13a-14(a)/15d-14(a) Certification of John T. Drexler.
32.1	Section 1350 Certification of John W. Eaves.
32.2	Section 1350 Certification of John T. Drexler.
95	Mine Safety Disclosure required by Item 104 of Regulation S-K
101	Interactive Data File (Form 10-Q for the period ended March 31, 2013 filed in XBRL). The financial information contained in the XBRL-related documents is unaudited and unreviewed.

**Signatures**

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

Arch Coal, Inc.

By:

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

May 8, 2013