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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

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

For the transition period from to .

Commission file number: 1-13105

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 x No o

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

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

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

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

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

Table of Contents

TABLE OF CONTENTS

Table of Contents

Part I

FINANCIAL INFORMATION

Item 1. Financial Statements.

Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

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

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

3

Table of Contents

Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Loss)

(in thousands)

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

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

Table of Contents

Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except per share data)

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

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

5

Table of Contents

Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

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

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

Table of Contents

Arch Coal, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Basis of Presentation

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

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

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

2. Accounting Policies

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

3. Accumulated Other Comprehensive Income

The following items are included in accumulated other comprehensive income:

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

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

Table of Contents

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

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

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

4. Divestitures

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

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

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

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

Table of Contents

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

5. Inventories

Inventories consist of the following:

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

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

6. Investments in Available-for-Sale Securities

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

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

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

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

	December 31, 2013											
									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	$	65,002	$	11	$	(75)	$	64,938	$	64,938	$	
Corporate notes and bonds		184,773		7		(1,304)		183,476		183,476		
Equity securities		5,271		13,660		(2,902)		16,029				16,029
Total Investments	$	255,046	$	13,678	$	(4,281)	$	264,443	$	248,414	$	16,029

Table of Contents

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

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

7.   Derivatives

Diesel fuel price risk management

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

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

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

Coal price risk management positions

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

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

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

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

Coal trading positions

The Company may sell or purchase forward contracts, swaps and options in the over-the-counter coal market for trading purposes. The Company is exposed to the risk of changes in coal prices on the value of its coal trading portfolio. The estimated future realization of the value of the trading portfolio is $6.6 million of gains during the remainder of 2014 and $1.4 million of gains in 2015.

Table of Contents

Tabular derivatives disclosures

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

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

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

The Company had a current asset for the right to reclaim cash collateral of $6.5 million at March 31, 2014 and $2.2 million at December 31, 2013. These amounts are not included with the derivatives presented in the table above and are included in other current assets in the accompanying condensed consolidated balance sheets.

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

Derivatives used in Cash Flow Hedging Relationships (in thousands)

For the Three Months Ended March 31,

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

Table of Contents

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

Derivatives Not Designated as Hedging Instruments (in thousands)

For the Three Months Ended March 31,

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

Location in statement of operations:

(1) Revenues

(2) Cost of sales

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

(4) Other operating income, net

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

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

8. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

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

Table of Contents

9. Debt and Financing Arrangements

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

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

10. Income taxes

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

11. Fair Value Measurements

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

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

- Level 2 is defined as observable inputs other than Level 1 prices. These include quoted prices for similar assets or liabilities in an active market, quoted prices for identical assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company s level 2 assets and liabilities include U.S.

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

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

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

Table of Contents

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

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

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

	Three Months Ended March 31, 2014 (In thousands)
Balance, beginning of period	$ 4,946
Realized and unrealized losses recognized in earnings, net	(2,925)
Purchases	1,956
Ending balance	$ 3,977

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

Fair Value of Long-Term Debt

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

12. Loss Per Common Share

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

13. Employee Benefit Plans

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

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

Table of Contents

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

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

14. Commitments and Contingencies

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

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

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

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

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

Table of Contents

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

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

15. Segment Information

The Company s reportable business segments are based on the major coal producing basins in which the Company operates and may include a number of mine complexes. The Company manages its coal sales by coal basin, not by individual mining complex. Geology, coal transportation routes to customers, regulatory environments and coal quality or type are characteristic to a basin, and, accordingly, market and contract pricing have developed by coal basin. Mining operations are evaluated based on their per-ton operating costs (defined as including all mining costs but excluding pass-through transportation expenses), as well as on other non-financial measures, such as safety and environmental performance. The Company s reportable segments are the Powder River Basin (PRB) segment, with operations in Wyoming; and the Appalachia (APP) segment, with operations in West Virginia, Kentucky, Maryland and Virginia. The Other category combines other operating segments and includes the Company s coal mining operations in Colorado and Illinois and its ADDCAR subsidiary, which the Company sold in the first quarter of 2014.

Operating segment results for the three months ended March 31, 2014 and 2013 are presented below. Results for the reportable segments include all direct costs of mining, including all depreciation, depletion and amortization related to the mining operations, even if the assets are not recorded at the operating segment level. These reportable segments results do not reflect the mine closure or impairment costs, since those are not reflected in the operating income reviewed by management. Corporate, Other and Eliminations includes these charges, as well as the change in fair value of coal derivatives and coal trading activities, net; corporate overhead; land management; other support functions; and the elimination of intercompany transactions. The operating segment results reflect only those from continuing operations, and exclude the results of Canyon Fuel, since they are classified as discontinued operations in the condensed consolidated statements of operations.

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

Table of Contents

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

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

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

16. Supplemental Consolidating Financial Information

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

Table of Contents

Condensed Consolidating Statements of Operations

Three Months Ended March 31, 2014

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

Table of Contents

Condensed Consolidating Statements of Operations

Three Months Ended March 31, 2013

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

Table of Contents

Condensed Consolidating Balance Sheets

March 31, 2014

	Parent/Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (In thousands)	Eliminations	Consolidated
Assets					
Cash and cash equivalents	$ 753,902	$ 100,353	$ 11,506	$	$ 865,761
Short term investments	248,572				248,572
Receivables	33,115	16,594	229,737	(4,634)	274,812
Inventories		224,806			224,806
Other	80,500	42,347	530		123,377
Total current assets	1,116,089	384,100	241,773	(4,634)	1,737,328
Property, plant and equipment, net	23,765	6,592,317	28	34	6,616,144
Investment in subsidiaries					